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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1994

PEOPLE OF THE STATE OF CALIFORNIA and
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA
Petitioners,
VS.
FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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January 3, 1995

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QUESTION PRESENTED

May the Federal Communications Commission lawfully preempt state regulation applicable solely to the intrastate services of a local telephone company whenever the FCC believes that such state regulation is economically inefficient?

LIST OF PARTIES

Ad Hoc Telecommunications Users Committee
ADT Security Systems
American Telephone and Telegraph Company
Ameritech Corporation
Association of Telemessaging Services International
Bell Atlantic Corporation
Bell Atlantic Systems Leasing International, Inc.
Bell Atlantic Tricon Leasing Corporation
Bell Atlantic Financial Services, Inc.
Bell Atlantic Mobile Systems, Inc.
Bell Atlantic Network Funding Corporation
Bell Atlantic Capital Funding Corporation
BellSouth Corporation
California Cable Television Association
Compuserve, Inc.
District of Columbia Public Service Commission
Federal Communications Commission and the United States of America
Florida Public Service Commission
GTE Service Corporation
H&R Block, Inc.
Information Industry Association
Information Technology Association of America
International Business Machines Corporation
Maryland People's Counsel
MCI Communications Corporation
Metromedia Paging Services
National Association of Regulatory Utility Commissioners
Newspaper Association of America
New York State Department of Public Service
North American Telecommunications Association
NYNEX Corporation
Pacific Telesis Group
Pennsylvania Office of Consumer Advocate

Pennsylvania Public Utility Commission
People of the State of California and the Public Utilities Commission of the State of California
Southwestern Bell Corporation
Southwestern Bell International Holdings Corporation
Southwestern Bell Publications, Inc.
Southwestern Bell Telecommunications, Inc.
Southwestern Bell Mobile Systems, Inc.
Sprint Communications Company
Telecom Corporation of New Zealand
United States Department of Justice
United States Telephone Association
U S WEST, Inc.
Voice-Tel Enterprises

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No. _____

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The People of the State of California and the Public Utilities Commission of the State of California ("California") respectfully petition that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered on October 18, 1994.

OPINION AND ORDER BELOW

The opinion of the Ninth Circuit is reported at *People of the State of California v. Federal Communications Commission*, No. 92-70083 (9th Cir. Oct. 18, 1994) ("*Califor-*

nia II"), and is reproduced in the Appendix, A1-34.[1] The order of the Federal Communications Commission, *In the Matter of Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards*, CC Docket 90-623, Report and Order (*"Order on Remand"*), is reported at 6 F.C.C. Rcd 7571 (1991), and is reproduced in the Appendix, B1-110.

JURISDICTION

The judgment of the Ninth Circuit was entered on October 18, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant statutory provisions are set forth in the Appendix, C1-2.

STATEMENT OF THE CASE

1. Statement of Facts

The Communications Act of 1934 ("Act"), 47 U.S.C. § 151 *et seq.*, establishes a dual federal-state regulatory scheme governing the telephone network. Under this scheme, Congress has charged the Federal Communications Commission ("FCC") with regulating interstate services and facilities. Congress, however, expressly fenced off from FCC reach or regulation intrastate services and facilities, reserving authority over such matters to the states. 47 U.S.C. § 152(b).[2]

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[1] As herein used, numerals preceded by letters refer to page numbers in the appendix to this petition.

[2] 47 U.S.C. § 152(b) states in part that "nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with

In this case, the FCC has scaled the Section 152(b) fence by preempting state structural safeguards requiring a local telephone company to separate its marketing personnel or any of its facilities used in connection with intrastate "enhanced" services from marketing personnel or facilities used in connection with its intrastate and interstate basic monopoly telephone services.[3] Structural safeguards have long proven to be effective deterrents to improper cross-subsidization and discriminatory access by a local telephone company.[4] The FCC, however, has eliminated such safeguards for the company's interstate enhanced services, and instead has given the company sole discretion either to separate or integrate the marketing and other operations of its interstate enhanced services with the marketing and other operations of its interstate and intrastate basic monopoly services. Should the telephone company choose to integrate its provision of interstate enhanced and basic services, the FCC has prescribed a set of nonstructural safeguards to replace the structural ones, which the FCC believes allow the telephone company to be more efficient, and hence more

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respect to (1) charges, classifications, practices, services, facilities or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . ." Section 152(b) is set forth in full in the Appendix, C1-2.

[3] Enhanced services use computerized data processing to convey information to users over the telephone network. Examples include voice mail and LEXIS.

[4] Structural safeguards require a company to separate in whole or in part its competitive services operations from its monopoly telephone services operations. Such safeguards prevent or deter the company from improperly deriving revenues from or shifting costs to captive ratepayers of basic monopoly telephone service in order to subsidize the company's competitive enhanced services. Structural safeguards also prevent or deter a local telephone company from gaining an unfair competitive edge by giving discriminatory access either to basic telephone transmission services or information about those services for its own enhanced offerings.

competitive in offering its enhanced services. [5] The federal framework is designed expressly to further the policy goals of Section 151 "to make available . . . a rapid, efficient Nationwide and world-wide wire and radio communication service." 47 U.S.C. § 151;[6] *California II, slip op.* at 12770, App. at A29.

In *California II*, the decision below, the FCC does not claim that state regulation applicable only to the intrastate portion of enhanced services negates the FCC's authority to promulgate accounting rules and other safeguards applicable to the interstate portion. Nor does the FCC claim that it is impossible for differing state and federal regulatory regimes to co-exist for interstate and intrastate enhanced services offered by a telephone company. *Id., slip op.* at 12774, App. at A33.[7] Indeed, the FCC has acknowledged that states could require a local telephone company to assign separate personnel to a separate corporate entity for the purpose of accounting for the company's intrastate enhanced services. *Id., slip op.* at 12772, App. at A31. The FCC nevertheless believes that a company's compliance with state regulations

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[5] In lieu of structural safeguards to prevent improper cross-subsidization and discriminatory access, the FCC has prescribed for interstate services accounting rules which apportion the costs between the telephone company's interstate basic and interstate enhanced services operations; rules known as "open network architecture" which provide competitors of enhanced services access to segregated or unbundled components of the local telephone company's network; and rules governing the disclosure of network and customer information.

[6] Section 151 is set forth in full in the Appendix, C1.

[7] In the decision below, neither the FCC nor its supporters disputed that it would be possible for a telephone company to assign separate personnel to market intrastate enhanced services on the one hand, and interstate enhanced and all basic services on the other. Nor did the FCC or its supporters dispute that it would be possible for a telephone company to reserve equipment exclusively for intrastate enhanced services.

requiring separate personnel for marketing the company's intrastate enhanced services or requiring the separation of any of its facilities for such intrastate services may be economically inefficient or practically burdensome to the company.[8] The FCC further assumes that any additional costs imposed by state regulation of intrastate services will be borne by the shareholders of the telephone company and not its ratepayers, notwithstanding that a state may determine otherwise. The FCC thus reasons that because a telephone company would opt to comply with state regulations for both its interstate and intrastate enhanced services, or perhaps not offer such services at all, state regulations would defeat the FCC's Section 151-derived policy of encouraging the telephone company to be more efficient and more competitive.

Accordingly, conceding that it is possible for dual federal-state regulation to exist, but solely to prevent frustration of its Section 151-derived policies, the FCC has preempted the states.

2. Proceedings Below

The FCC order challenged in the decision below stems from a remand of the FCC's *Computer III* orders by the Ninth Circuit in *California v. FCC*, 905 F.2d 1217, 1223 n.1 (9th Cir. 1990) (*"California I"*). In *California I*, the Ninth Circuit vacated and remanded the FCC's *Computer III*

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[8] In its brief before the Ninth Circuit, the FCC conceded that the argument that a local telephone company may not be able to identify the jurisdiction of one enhanced service, voice mail service, in order to route intrastate voice mail calls to separate equipment may be valid only "in some instances." Resp. Br. at 36. Moreover, the FCC did not dispute that the argument has no relevance to whether the company is able to assign separate personnel in order to market intrastate enhanced services. Finally, the FCC cannot dispute that customers today are required to deal with separate marketing personnel from two different companies for their intrastate services and interstate services.

orders on two grounds. First, it held that the FCC had acted arbitrarily and capriciously in removing structural separation requirements under which a local telephone company provided its interstate enhanced services. Second, it held that the FCC had exceeded its lawful authority in preempting the states from tariffing intrastate enhanced services offered by a local telephone company and from prescribing structural and other consumer safeguards governing the company's provision of intrastate enhanced services.

Relying on *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355(1986), and *Nat'l. Ass'n of Regul. Util. Comm'rs. v. FCC*, 880 F.2d 422 (D.C. Cir. 1989) in overturning the FCC's preemptive rulings, the Ninth Circuit held that Section 152(b) fenced off from FCC reach not only intrastate basic telephone services, but also intrastate enhanced services offered by a local telephone company. *California I*, 905 F.2d at 1242. The Ninth Circuit also held that the FCC failed to demonstrate that state structural and other safeguards applicable only to the intrastate enhanced services of a local telephone company negated the exercise by the FCC of its own lawful authority over interstate services. *Id.* at 1243.

Following its defeat in *California I*, the FCC initiated a new proceeding in which it sought to reinstate the *Computer III* regulatory regime, including most of its preemptive rulings.[9] During the pendency of the remand proceeding, the FCC was presented with an order of the Georgia Public Service Commission ("Georgia") which found that BellSouth, the local telephone company, had engaged in marketing abuses and undue discrimination to the detriment of BellSouth's captive intrastate ratepayers and voice mail

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[9] *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards*, CC Docket 90-623, Notice of Proposed Rulemaking and Order, 6 F.C.C. Rcd 174 (1990).

competitors by offering its local voice mail services jointly with its regulated monopoly telephone services under federal nonstructural safeguards. *California II, slip op.* at 12765-12766 App. at A24-25.

The FCC did not dispute the findings of Georgia. Nevertheless, the FCC concluded in the *Order on Remand* that, even upon a state finding of compelling evidence of anticompetitive conduct, the FCC must preempt a state from requiring the local telephone company to structurally separate its marketing personnel or equipment for intrastate voice mail or other intrastate enhanced services from its marketing personnel or equipment for its interstate and intrastate monopoly telephone services. The FCC claimed that state regulation, although confined to intrastate services, would impose added costs on the telephone company, and hence thwart or impede the federal policy of encouraging telephone company efficiency and competitiveness. *Order on Remand*, 6 F.C.C. Rcd at 7574, 7630 ¶¶ 5, 121, App. at B5-6, 89-90.[10]

Thereafter, California and the New York Public Service Commission petitioned for review of the *Order on Remand.* Numerous other state parties intervened.

On October 18, 1994, the United States Court of Appeals for the Ninth Circuit vacated that portion of the FCC's *Order on Remand* in which the FCC replaced its structural separation requirements with nonstructural safeguards governing a telephone company's interstate services, but upheld that portion of the FCC's order which preempted the states from requiring certain structural and other safe-

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[10] Several local telephone companies, however, already offer their enhanced services through partially or fully separate corporate entities, with personnel and facilities separate and apart from personnel and facilities used in connection with the company's basic monopoly telephone services. 6 F.C.C. Rcd at 7616, ¶ 96, App. at B67-68.

guards governing a telephone company's intrastate enhanced services. *California II, slip op.* at 12775, App. at A34.

In its decision, the Ninth Circuit reiterated that "the only limitation on a state's authority over intrastate telephone service is 'when the state's exercise of that authority negates the exercise by the FCC of its own lawful authority over interstate communication.'" *California II, slip op.* at 12771, App. at A30, *citing California I*, 905 F.2d at 1243. The Ninth Circuit referred to this limitation as the "impossibility exception" and reaffirmed that "the impossibility exception is narrow." *California II, slip op.* at 12771, App. at A30. The Ninth Circuit then concluded that the FCC had properly invoked this exception because the FCC determined that it would be more expensive, and hence "impossible," for the telephone company to comply with different federal and state safeguards governing interstate and intrastate services. *Id., slip op.* at 12773, App. at A32. Like the FCC, the Court assumed that a state would require the shareholders, not the ratepayers, of the local telephone company to bear the intrastate costs of state regulation.

The Ninth Circuit cited the *NCUC*[11] decisions of the Fourth Circuit as analogous. The Ninth Circuit explained that in those cases, the Fourth Circuit upheld federal preemption "[b]ecause the state regulations would effectively negate the FCC's regulation" promulgated under Sections 201-205 which "authoriz[ed] the use of customer provided equipment for interstate services." *Id., slip op.* at 12774, App. at A33. Here, however, unlike in the *NCUC* decisions and indeed contrary to those decisions, the Ninth Circuit has upheld federal preemption not because the state regulation would negate the FCC's ability to promulgate

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[11] *North Carol. Utils. Comm'n v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976) (*"NCUC I"*); *North Carol. Utils. Comm'n v. FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) (*"NCUC II"*).

accounting and other regulations applicable to interstate services, but because state regulation, confined to intrastate services, would frustrate the FCC's Section 151-derived economic efficiency goals underlying such federal regulations. *Id., slip op.* at 12775, App. at A34. The Ninth Circuit's ruling thus elevates the FCC to a court of review of state regulation of intrastate service on issues of cost and efficiency.

This petition follows.

REASONS FOR ALLOWANCE OF THE WRIT

The Ninth Circuit has sanctioned a federal preemption standard that effectively allows the FCC to read the states out of the Communications Act any time the FCC believes that state regulation, confined to the intrastate sphere, will impose added costs or inefficiencies on the local telephone company, and hence will thwart or impede the policies contained in the general purpose language of Section 151 and underlying federal regulation in the interstate sphere. If allowed to stand, the decision below will nullify Congress' express reservation in Section 152(b) of authority to the states over facilities and services for or in connection with the intrastate portion of jurisdictionally mixed services.

The Ninth Circuit's decision also directly conflicts with *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355 (1986), even though as a matter of law the two decisions are indistinguishable. In *Louisiana,* this Court held that the FCC may not "expand its power [into the intrastate domain] in the face of a congressional limitation on its jurisdiction" in order to "effectuate a federal policy" underlying FCC regulation in the interstate domain. 476 U.S. at 374. If allowed to stand, the decision below will effectively overrule *Louisiana.*

Finally, the Ninth Circuit's decision directly conflicts with the Fourth Circuit's *NCUC* decisions. In those decisions, the Fourth Circuit explicitly recognized that Congress intended the states to choose whether to avoid the economic and political costs to intrastate customers of requiring the local telephone company to comply with differing state regulations applicable only to the intrastate portion of the company's operations. In the decision below, the Ninth Circuit permits the FCC to oust the state from making that choice.

I

THE NINTH CIRCUIT HAS DECIDED A QUESTION OF FEDERAL LAW IN A WAY THAT DIRECTLY CONFLICTS WITH THE INTENT OF CONGRESS AND THE PREEMPTION DECISIONS OF THIS COURT

In *Louisiana*, the Court reaffirmed Congress' intent, in enacting Section 152(b) of the Communications Act, to erect a jurisdictional fence and to confine the FCC's exercise of authority to the interstate side of that fence. 476 U.S. at 370. The Court further reaffirmed Congress' intent that the FCC could not lawfully scale this fence and preempt state regulation otherwise confined to the intrastate side in order to "effectuate a federal policy" derived by the FCC from the general purpose language of Section 151 and underlying federal regulation on the interstate side. *Id.* at 374; *Northwest Central Pipeline Corp. v. State Corp. Comm'n of Kansas*, 489 U.S. 493, 515 n.12 (1989); *Cf. MCI Telecomms. Corp. v. AT&T*, 512 U.S. ____, 114 S.Ct. 2223, 2233 (1994) ("the Commission's desire 'to increase competition' cannot provide [it] authority to alter the well-established statutory . . . requirements.") (citation omitted).

In the decision below, the Ninth Circuit cites the FCC's reliance on the general purpose language of Sec-

tion 151 as a source of federal authority over interstate communication service and then concludes under that section that the FCC may override the express jurisdictional bar of Section 152(b) if the FCC demonstrates that "state regulation would negate valid FCC regulatory goals." *California II, slip op.* at 12770, 12771, App. at A29, 30. The decision thus thwarts congressional intent as reaffirmed in *Louisiana* by allowing the FCC to resurrect Section 151 as a basis upon which it may override Section 152(b).

As a matter of law, *Louisiana* and the decision below are indistinguishable. In both *Louisiana* and the decision below, the FCC had prescribed regulations, the objective of which was to further the goal of Section 151 by encouraging economic efficiency, and hence competitiveness by a telephone company in offering new services. *Louisiana*, 476 U.S. at 369, and *California II, slip op.* at 12756, App. at A15. Similarly, in both *Louisiana* and the decision below, the FCC acknowledged that it was possible for telephone companies to comply with both state and federal regulations. *Louisiana*, 476 U.S. at 375, and *California II, slip op.* at 12774, App. at A33. The FCC's sole argument in each case was that state regulation, although confined to the intrastate portion of dual-use facilities, must be preempted because such regulation would frustrate the FCC's Section 151-derived goals of efficiency and competitiveness underlying, respectively, its depreciation regulations and its nonstructural safeguards applicable to interstate services. *Louisiana*, 476 U.S. at 369, and *California II, slip op.* at 12775, App. at A34.

In *Louisiana*, this Court reversed the FCC order not because the FCC failed to demonstrate that state regulation would "frustrate the federal policy" and defeat the "whole purpose" underlying the federal regulation at issue there (the state arguably did both), but because the FCC failed to show that state regulation prevented the FCC from prescrib-

ing federal regulations governing interstate facilities. 476 U.S. at 369, 376.

In contrast, the decision below upholds the FCC order precisely and solely because the FCC believes that state regulation, concededly confined to intrastate services and facilities, would nevertheless frustrate the very same federal policy at issue in *Louisiana* (advancement of competition) and negate the goal or purpose underlying the FCC-prescribed safeguards governing interstate services. The decision below thus squarely conflicts with and effectively overrules *Louisiana* by allowing the FCC to "expand its power [into the intrastate domain] in the face of a congressional limitation on its jurisdiction" in order to achieve the Section 151-derived policy goals underlying federal regulation in the interstate domain.[12] *Louisiana*, 476 U.S. at 374; *Cf. MCI Telecomms. Corp. v. AT&T*, 114 S.Ct. at 2232.

II

THE COURT SHOULD REVIEW THIS CASE BECAUSE IT CREATES A CONFLICT BETWEEN CIRCUIT COURTS OF APPEAL

The Ninth Circuit mistakenly believes that this case is distinguishable from *Louisiana* and analogous to cases from the Fourth Circuit cited by this Court in footnote four of that decision. 476 U.S. at 375 n.4, *citing NCUC* cases. In *Louisiana*, this Court observed that "where it was *not* possible to separate the interstate and the intrastate components of the asserted FCC regulation" and "state regulation would negate the federal tariff," the FCC could legitimately preempt the state regulation. *Id.* (emphasis in original).

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[12] California agrees with New York's petition filed herein which makes the same point.

In fact, the Ninth Circuit decision directly conflicts with the decisions from the Fourth Circuit by overlooking a critical distinction present in the *NCUC* cases which, unlike the decision below, maintains the integrity of the dual regulatory scheme of the Communications Act. In the *NCUC* cases, the state had prohibited customers from connecting phones not provided by the telephone company to the network. The FCC, however, permitted such interconnection, invoking its specifically delegated authority under Sections 201-205 of the Act. *NCUC I*, 537 F.2d at 792. Because the state chose to avoid the "economic and political costs of forcing the general consumer to buy two sets of terminal equipment," one for interstate use, and another for intrastate use, *NCUC II*, 552 F.2d at 1049, "[s]omething had to give" since a customer could not simultaneously comply with both federal and state regulations governing a single telephone. *Id.* at 1043. The Fourth Circuit upheld federal preemption because the state regulation rendered "nugatory" the specific "federal tariffs authorizing interconnection." *Id.*

Thus, in the *NCUC* cases, it was the *state*, by choosing not to force customers to have two telephones, that made it impossible "to separate the interstate and the intrastate components of the asserted FCC regulation." *Louisiana*, 476 U.S. at 375 n.4; *NCUC II*, 552 F.2d at 1049.[13] Had the state chosen instead to bear the "economic and political costs" of requiring customers to have two telephones, one for interstate use and another for intrastate use, then it would not have been impossible for customers to comply

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[13] The Fourth Circuit said that "the Commission's construction makes the term 'facilities' meaningless not because exclusively intrastate facilities cannot be built or imagined (indeed, some are already in existence), but because *state commissions prefer to avoid the economic and political costs* of forcing the general consumer to buy two sets of terminal equipment." *NCUC II*, 552 F.2d at 1049 (emphasis added).

with both federal and state regulations, and federal tariffs authorizing the interconnection of any telephone would not have been negated. *NCUC II*, 552 F.2d at 1049. The Fourth Circuit thus recognized that the state's choice created a situation of impossibility.

In contrast, the decision below allows the FCC unilaterally to define a situation of "impossibility" by taking away from the states the right expressly reserved by Congress to weigh the economic costs as well as benefits to intrastate ratepayers of requiring a local telephone company to comply with differing state regulations confined to the intrastate portion of its operations, and to determine whether to recover any such intrastate costs either from the telephone company or its ratepayers.[14] Having defined such a situation, the FCC then empowers itself to preempt the states from acting altogether, thereby "expand[ing] its power in the face of a congressional limitation on its jurisdiction." *Louisiana*, 476 U.S. at 374.

To be sure, had this preemption standard, at odds with the *NCUC* decisions, been applied in *Louisiana*, the states would have lost the case. In *Louisiana*, the FCC and telephone companies believed not only that differing state regulation would frustrate the "whole purpose" of federal regulation, *id.* at 376, and thwart the federal objectives underlying such regulation, *id.* at 363, 369, but that differing state regulation would imperil the economic well-being of the entire telecommunications industry. Specifically, it was argued that state depreciation rates, applicable to 75 percent of telephone company assets, would not allow the telephone companies to recoup some $26 billion in investment, thereby

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[14] Given that the costs of additional personnel or facilities for intrastate enhanced services are intrastate only, incurred only in the intrastate sphere and not accounted for on interstate ledgers, Congress has provided that the FCC may not properly intrude to determine whether such intrastate costs are reasonable. 47 U.S.C. § 152(b).

adversely affecting the economic ability of the telephone companies to provide services competitively. *Id.* at 359, 376. The telephone companies argued further that inconsistent state regulations governing their intrastate assets would place a "severe impact on the interstate communications network," *id.* at 373, "threaten[ ] the financial ability of the industry to achieve the technological progress and provide the quality of service that the Act was passed to promote," *id.* at 359, and "jeopardize the continued viability of the telecommunications industry," *id.* at 368, all in derogation of the congressional policy set forth in Section 151 of the Act.

The Court rejected all of these arguments of economic burden and economic irrationality as insufficient justification to preempt the states. Instead, in distinguishing the *NCUC* cases, the Court recognized first, that it was "certainly possible to apply different rates and methods of depreciation" to telephone equipment used jointly for interstate and intrastate services, *id.* at 375; second, and consistent with the *NCUC* cases, that Congress left it to the states to weigh, based on "principles, judgments and considerations" of public policy, the overall costs and benefits to the telephone company and its intrastate ratepayers of state regulation confined to intrastate services, *id.* at 376; and third, that "actions taken by federal and state regulators within their respective domains necessarily affect the general financial health of those carriers, and hence their ability to provide service in the other 'hemisphere.'" *Id.* at 360. Without deprecating the FCC's concerns, the Court then held that "§ 152(b) precludes both the FCC and this Court from providing the relief sought. As we so often admonish, only Congress can rewrite this statute." *Id.* at 376.

In contrast, the Ninth Circuit impermissibly allows the FCC to take matters into its own hands to achieve the objectives of Section 151 by giving preemptive weight to

similar, but less compelling, arguments of economic burden or irrationality caused by state regulation confined to the intrastate domain.[15] Specifically, the decision below sanctions federal preemption — notwithstanding that it is certainly possible for the telephone company to comply simultaneously with differing state and federal requirements for the company's enhanced services — whenever the FCC believes that compliance with state requirements would either be too costly or too burdensome for the company.[16] *Id.*, *slip op.* at 12774, A33. Thus, contrary to the *NCUC* cases and *Louisiana*, the FCC is allowed effectively to oust the states from weighing the costs and benefits of state regulation confined to intrastate services and facilities, including how to recover any intrastate costs, and to reduce

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[15] Contrary to the Ninth Circuit, the D.C. Circuit expressly recognized that state regulation cannot legitimately be preempted even if it "imposes too great an economic burden on carriers engaged in both interstate and intrastate communications" or is "economically irrational." *Pub. Serv. Comm'n of Maryland v. FCC*, 909 F.2d 1510, 1516 (D.C. Cir. 1990). In that case, the state was preempted because it directly set charges for an interstate service. *Id.* at 1516. This constitutes an additional conflict between circuits.

[16] In the decision below, the FCC never addresses the fact that its own regulations will permit or require inefficient duplication of telephone company personnel or facilities. The FCC has allowed the states to require the telephone company to assign separate personnel in a separate corporate entity for the purpose of accounting for the costs of intrastate enhanced services. *California II, slip op.* at 12772, App. at A31. The FCC has also conceded that federal safeguards governing access to customer information will require the telephone company to assign separate personnel for marketing interstate enhanced services on the one hand, and basic monopoly telephone services on the other, for customers with more than 20 lines or for any other customer who requests restricted access to such information. *Order on Remand*, 6 F.C.C. Rcd at 7609, 7610-11, ¶¶ 83,84 and n.155, App. at B57-58, 59-60. The FCC cannot rationally conclude that duplicative personnel or facilities is "uneconomic" and "impractical" to the local telephone company when its own regulations produce that result.

the states to regulating purely intrastate services and facilities, a result which "misrepresents the statutory scheme and the basis and test for pre-emption" which Congress prescribed. *Louisiana*, 476 U.S. at 374.[17]

To be sure, Congress did not draw a line beyond which the FCC could unilaterally conclude that the dual regulatory scheme is too expensive or cumbersome to the carriers.[18] If the economic or practical burden of the dual scheme becomes too great, the answer for the FCC is to return to Congress to rewrite the law, not for the FCC to confer authority upon itself. *Louisiana*, 476 U.S. at 376; *MCI Telecomms. Corp. v. AT&T*, 114 S.Ct. at 2232.

The decision below also upsets the balance of state and federal authority struck by Congress by improperly elevating the business judgment of the regulated local telephone company over the judgment of the state commission charged with regulating the intrastate operations of that company. *Order on Remand*, 6 F.C.C. Rcd at 7623, ¶ 108, App. at B79 (structural separation constitutes an "unnecessary government intrusion into business judgments by the BOCs regarding the most effective corporate organization for the provision of enhanced services."). The company's concern with efficiency, however, cannot legitimately override a state's concern in safeguarding the interests of the company's captive customers of intrastate services. Under the dual regulatory scheme, Congress did not leave it to the FCC and the regulated companies, but to the FCC and the states to determine within their respective regulatory

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[17] And even that reservation of authority to the states is illusory given the FCC's view that any facilities or services which interconnect with the national network are partly interstate. 6 F.C.C. Rcd at 7633, n.249, App. at B93.

[18] While no state would rationally impose costs which would drive a company out of business, any state order considered unduly burdensome by the company could be challenged in accordance with applicable law.

spheres whether the costs and benefits of particular federal and state regulations serve the public interest.

In the end, the logic of the preemption standard sanctioned by the Ninth Circuit permits no principled stopping point, and allows the FCC to dismantle the jurisdictional fence of Section 152(b) which Congress so carefully constructed.[19] If in order to justify preemption the FCC need only show that compliance with the dual regulatory scheme, which by definition imposes greater costs than a uniform scheme, is uneconomic or burdensome to the local telephone company, then nothing prevents the FCC from overriding any and all state regulations, otherwise confined to intrastate services, that differ from its own.[20] *Louisiana*, however, makes clear that the FCC may not act in an area over which Congress has explicitly denied it jurisdiction, where, as here, it is possible to separate the components of state and federal regulation. *Northwest Central*, 489 U.S. 493, 515 n.12., *citing Louisiana*, 476 U.S. at 374; *Cf. MCI Telecomms. Corp. v. AT&T*, 114 S.Ct. at 2232.

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[19] The FCC's acknowledgement that it has declined to preempt state rate-setting of intrastate enhanced services at this time because state action does not yet frustrate federal policy illustrates the FCC's potentially limitless reach under the flawed preemption standard endorsed by the Ninth Circuit. Resps. Br. at 101.

[20] At stake are a host of state measures designed to protect the interests of captive customers of intrastate services and which differ from federal measures. These include rules limiting pre-recorded telephone solicitations to intrastate subscribers (Section 2874 of the Cal. Pub. Util. Code), rules allowing intrastate residential subscribers the option of deleting access to messages which constitute harmful manner as defined by California law (Section 2884(b) of the Cal. Pub. Util. Code), and rules protecting captive ratepayers from funding the competitive ventures of the local telephone company.

CONCLUSION

California respectfully requests that the Court issue a writ of certiorari to the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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January 3, 1995

Supreme Court, U.S.
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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1994

PEOPLE OF THE STATE OF CALIFORNIA and
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA
Petitioners,
VS.
FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,
Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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APPENDIX A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

THE PEOPLE OF THE STATE OF CALIFORNIA, ET AL.,
Petitioners,
PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA, ET AL.,
Petitioners-Intervenors,
v.
FEDERAL COMMUNICATIONS COMMISSION, ET AL.,
Respondents,
BELLSOUTH CORPORATION, ET AL.,
Respondents-Intervenors.

No. 92-70083

MCI COMMUNICATIONS CORPORATION,
Petitioner,
MARYLAND PEOPLE'S COUNSEL, ET AL.,
Petitioners-Intervenors,
v.
FEDERAL COMMUNICATIONS COMMISSION, ET AL.,
Respondents,
VOICE-TEL ENTERPRISES, INC., ET AL.,
Respondents-Intervenors.

No. 92-70186

STATE OF NEW YORK, ET AL.,
Petitioners,
MARYLAND PEOPLE'S COUNSEL, ET AL.,
Petitioners-Intervenors,
v.
FEDERAL COMMUNICATIONS COMMISSION, ET AL.,
Respondents,
VOICE-TEL ENTERPRISES, INC., ET AL.,
Respondents-Intervenors.

No. 92-70217

AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION ("ANPA"), ET AL.,
Petitioners,
BELLSOUTH CORPORATION, ET AL.,
Intervenors,
v.
FEDERAL COMMUNICATIONS COMMISSION, ET AL.,
Respondents.

No. 92-70261
OPINION

Appeal from an Order of the
Federal Communications Commission

Argued and Submitted
April 11, 1994 — San Francisco, California

Filed October 18, 1994

Before: Mary M. Schroeder, Dorothy W. Nelson, and William C. Canby, Jr., Circuit Judges.

Opinion by Judge Schroeder

SUMMARY

GOVERNMENT LAW / COMMUNICATIONS / ADMINISTRATIVE LAW

The court of appeals granted a petition for review of an order of the Federal Communications Commission (FCC), vacated in part an FCC order, and remanded to the FCC. The court held that part of an FCC order is arbitrary and capricious due to the FCC's failure to explain or justify its change in policy regarding nonstructural safeguards against Regional Bell Operating Companies' (BOCs') discriminating in favor of their own enhanced services in providing access to telephone transmission facilities.

Certain FCC orders, known as *Computer III* specified the conditions under which the BOCs could provide enhanced computerized data services to their customers in addition to providing basic telephone service. *Computer III* eliminated earlier requirements that the BOCs maintain separate corporate structures for the provision of enhanced services. Because state regulations had also required structural separation, *Computer III* also ordered that such state requirements be preempted by the federal directive.

In *California v. FCC (California I)*, the court of appeals remanded for reconsideration of the *Computer III* orders. The court remanded for the FCC to reconsider certain aspects of the cost benefit analysis underlying the elimination of structural separation. The court also directed the FCC to reconsider its preemption order in light of the Federal Communications Act requirement that preemption be narrowly tailored to promote dual, state and federal, regulatory goals.

In the order issued on remand, *Computer III Remand Proceedings Order (Order on Remand)*, the FCC once again eliminated structural separation requirements, but imposed strengthened nonstructural safeguards intended to address the concerns the court of appeals expressed in *California I*. The FCC also modified its preemption order so that it no longer purported to preempt all state structural separation requirements, but only those affecting services that include both interstate and intrastate communications.

After *California I*, but before the entry of the *Order on Remand*, petitioners the people of the State of California, the Public Service Commission of the District of Columbia, MCI Communications Corp., the Maryland People's Counsel, the State of New York, and the American Newspaper Publishers Association, attacked a related series of FCC orders. The court of appeals reviewed the orders in *California II*, and found that the orders amounted to a retreat from the policy announced in *Computer III* of achieving the concept known as open network architecture (ONA) as a precondition to structure separation. The court held, however, that the change in policy itself did not violate the Administrative Procedures Act (APA), because it was adequately explained by the technological inability to achieve complete ONA.

Petitioners who are competitors of the BOCs in providing enhanced services to telephone customers (collectively, MCI) petitioned for review of the FCC order, challenging the FCC's cost benefit analysis in eliminating structural separation. They contended that the nonstructural safeguards are inadequate to prevent anti-competitive behavior by the BOCS. A second set of petitioners, represented by the States of California and New York, challenged the modified preemption aspects of the *Order on Remand*.

[1] On remand, the FCC established additional regulatory safeguards designed to reduce cross-subsidization;

[2] the FCC adopted mandatory price cap regulation for the BOCs and established new cost accounting rules that would make cross-subsidization easier to detect. **[3]** With the implementation of these measures, the FCC responded to the Ninth Circuit's concerns about the weakness of its position in *Computer III* and demonstrated that the BOCs' incentive and ability to cross-subsidize will be significantly reduced.

[4] In *California II*, the Ninth Circuit held that the FCC's ONA orders, now integrated into the *Order on Remand*, represented a change in policy from ONA as envisioned in *Computer III*. **[5]** The FCC, in the *Order on Remand*, as in its orders implementing ONA, has changed its requirements for, or definition of, ONA so that ONA no longer contemplates fundamental unbundling. Yet, in *Computer III*, the FCC regarded fundamental unbundling as a key safeguard against access discrimination. In the *Order on Remand*, the FCC never explained why it now authorizes lifting structural separation when it recognizes that its assumptions in *Computer III* regarding ONA have not proven correct, and that fundamental unbundling is not attainable at this time. Now that fundamental unbundling is no longer regarded as attainable, the FCC should have adjusted its cost benefit analysis accordingly. It did not do so. **[6]** Because the FCC's cost benefit analysis was flawed, the *Order on Remand* was set aside as arbitrary and capricious under the APA.

[7] MCI also challenged a provision in the *Order on Remand* that deals with Customer Proprietary Network Information (CPNI). **[8]** However, the new CPNI rules set forth in the order were not arbitrary and capricious.

[9] The FCC has presented adequate record support for its conclusion that because of economic and operational factors, enhanced service providers would separate their facilities for services that are offered both interstate and

intrastate, thereby essentially negating the FCC's goal of allowing integrated provision of enhanced and basic services.

[10] Thus, the FCC's preemption of state structural separation requirements was authorized in this case.

[11] The FCC's preemption of state regulations regarding CPNI and network disclosure rules was also affirmed. **[12]** The FCC met its burden of showing that its regulatory goals of authorizing integration of services would be negated by the state regulations it preempted. Thus, the preemption aspects of the *Order on Remand* were upheld.

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OPINION

SCHROEDER, Circuit Judge:

I. INTRODUCTION

We review the order that the Federal Communications Commission entered as a result of our decision in *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990) (*California I*). In that case, we remanded for reconsideration certain FCC orders, known as *Computer III*,[1] that specified the condi-

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[1]Report and Order, *In re Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, (Docket No. 85-229), 104 F.C.C.2d 958 (1986) *(Computer III)*, on *reconsideration*, 2 F.C.C.R. 3035 (1987); 2 F.C.C.R 3072 (1987); Memorandum Opinion and Order on Further Reconsideration, *In re Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, 3 F.C.C.R. 1135 (1988); Memorandum Opinion and Order on Reconsideration, *In re Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, 3 F.C.C.R 1150 (1988).

tions under which the Regional Bell Operating Companies (BOCS) could provide enhanced computerized data services to their customers in addition to. providing basic telephone service. *Computer III* eliminated earlier requirements that the BOCs maintain separate corporate structures for the provision of enhanced services. Because state regulations had also required structural separation, *Computer III* also ordered that such state requirements be preempted by the federal directive.

In *California I* we remanded for the FCC to reconsider certain aspects of the cost benefit analysis underlying the elimination of structural separation. We also directed the FCC to reconsider its preemption order in light of the Federal Communications Act requirement that preemption be narrowly tailored to promote dual, state and federal, regulatory goals.

In the order issued on remand, *Computer III Remand Proceedings Order*,[2] the FCC once again eliminated structural separation requirements, but imposed strengthened nonstructural safeguards intended to address the concerns we expressed in *California I*. The FCC also modified its preemption order so that it no longer purported to preempt all state structural separation requirements, but only those affecting services that include both interstate and intrastate communications.

After *California I*, but before the entry of the *Computer III Remand Proceedings Order*, (hereafter *Order on Remand*), petitioners in this proceeding also attacked a related series of FCC orders.[3] We reviewed those orders in *Califor-*

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[2]Report and Order, *In the Matter of Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier I Local Exchange Company Safeguards*, CC Docket 90-623, 6 F.C.C.R 7571 (1991).

[3]Memorandum Opinion and Order, *Filing and Review of Open Network Architecture Plans*, Phase I, FCC 88-381, 4 F.C.C.R 1 (1988);

nia v. FCC, 4 F.3d 1505 (9th Cir. 1993) (*California II*). We agreed with petitioners in that case that the orders under consideration amounted to a retreat from the policy announced in *Computer III* of achieving the concept known as open network architecture (ONA) as a precondition to structural separation. *Id.* at 1512. We held that ONA as envisioned in *Computer III* would have provided all enhanced service providers equal access to the components of the BOCs' telephonic network. We held, however, that the change in policy itself did not violate the Administrative Procedures Act, because it was adequately explained by the technological inability to achieve complete ONA. *Id.* at 1513.

At the time we were considering *California II*, the Commission had already entered the *Order on Remand*, but petitions for review of that decision had not yet been briefed. We therefore declined to decide whether the ONA policy change had an effect on the validity of the FCC's decision to eliminate structural separation. We held that all such issues should await our consideration of this order. *Id.*

Petitioners in this case are the same as petitioners in *California I* and *California II*, and are divided into two sets. The first, described collectively as MCI,[4] are competitors of

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Memorandum Opinion and Order on Reconsideration, *Filing and Review of Open Network Architecture Plans*, Phase I, FCC 90-134, 5 F.C.C.R. 3084 (1990); Memorandum Opinion and Order, *Filing and Review of Open Network Architecture Plans*, Phase I, FCC 90-135, 5 F.C.C.R 3103 (1990); and Report and Order, *Computer III Remand Proceedings*, FCC 90-415, 5 F.C.C.R. 7719 (1990).

[4]Petitioners are MCI Telecommunications Corporation and Newspaper Association of America. The following parties are intervenors in support of MCI: Compuserve, Inc., Information Technology Association of America, Information Industry Association, Pennsylvania Office of Consumer Advocate, and Maryland People's Counsel.

The following parties are intervenors in support of FCC on the MCI petitions: Illinois Bell, Indiana Bell, Michigan Bell, Ohio Bell, Wiscon-

the BOCs in providing enhanced services to telephone customers. They once again challenge the FCC's cost benefit analysis in eliminating structural separation, contending that the nonstructural safeguards are inadequate to prevent anticompetitive behavior by the BOCs. The second set of petitioners, represented by the States of California and New York, [5] challenge the modified preemption aspects of the *Order on Remand.*

We first consider MCI's petition challenging the elimination of structural separation. We hold that the FCC adequately responded to the concerns we expressed in *California I* by increasing the nonstructural safeguards designed to prevent the BOCs from passing on the costs of their enhanced services to their telephone customers paying regulated rates. We further hold, however, that the FCC's overall cost benefit analysis remains flawed. In *Computer III*, the FCC concluded that full ONA would be necessary to ensure fair competition between the BOCs and MCI in the absence of structural separation. We held in *California II* that the FCC had retreated from its position that full ONA was a prerequisite for eliminating structural separation to ensure access to the BOCs' networks. The *Order on*

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sin Bell, Bell Atlantic, BellSouth, Pacific Bell, Nevada Bell, Southwestern Bell, U.S. West Communications, Bell Operating Companies, United States Telephone Association, and NYNEX.

[5]The following parties are intervenors in support of California and New York: Florida Public Service Commission, Maryland People's Counsel, Pennsylvania Office of Consumer Advocate, Pennsylvania Public Utility Commission, and National Association of Regulatory Utility Commissioners.

The following parties are intervenors in support of FCC on the California and New York petitions: International Business Machines Corporation, American Telephone & Telegraph Company, Bell Atlantic, BellSouth, NYNEX, Pacific Bell, Nevada Bell, Southwestern Bell, U.S. West Communications, Information Industry Association, and Information Technology Association of America.

Remand does not take this change into account. Therefore, once again we remand for reconsideration of the cost benefit analysis with respect to structural separation.

In the California and New York petitions, we hold that the FCC has adequately addressed the concerns we raised in *California I*. We therefore affirm the preemption aspects of the FCC's *Order on Remand*.

II. STRUCTURAL SEPARATION

Background

In this case we deal with the "enhanced services industry" that in three decades has transformed the telephone lines into an information super highway. Enhanced services use computerized data processing to bring an ever expanding variety of information to users over the telephone communications network. That network is controlled by the Regional Bell Operating Companies that maintain monopolies over local telephone service that are regulated by the Federal Communications Commission.

From the inception of the enhanced services industry, the FCC has declined to regulate it in the interest of promoting competition among providers of enhanced services.[6] The FCC was concerned, however, that the telephone industry could use its monopoly of the lines to prevent competition from developing in the enhanced services industry. It sought to prevent the telephone carriers, which were eager to enter the enhanced services industry, from exploiting their monopoly over the telephone lines to obtain an unfair advan-

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[6]The history of the FCC's regulation of the enhanced services industry is set forth more fully in our opinion in *California I*, 905 F.2d at 1223-30.

tage. Therefore, in its Second Computer Inquiry,[7] the FCC in 1980 ordered that AT&T and its local exchange affiliates at that time, the Bell operating companies, form separate companies to provide enhanced services, companies that would have complete structural separation from the companies that provided basic telephone service. After the breakup of AT&T and the divestment of the Regional Bell Operating Companies, the FCC ordered that the BOCs maintain structural separation between their basic telephone operations and subsidiary entities providing enhanced services.[8]

The FCC adopted structural separation to prevent two problems. First, the FCC was concerned that the BOCs would gain an unfair competitive edge in the enhanced services industry by discriminating in favor of their own enhanced services in providing access to the telephone transmission facilities. Second, the FCC sought to prevent the BOCs from exploiting their monopolies over the telephone industry by cross-subsidization: passing on the costs of their enhanced services to regular telephone ratepayers who are required to use the carriers because of their monopoly over local phone services. These concerns are more fully discussed in *California I. See* 905 F.2d at 1224.

The structural separation requirement imposed by *Computer II* required the BOCs to produce and market enhanced services independent of their basic telephone services. Accordingly, the BOCs' enhanced service subsidiaries were required to maintain separate physical facilities, separate

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[7]Final Decision, *In re Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, 77 F.C.C.2d 384 (1980) (*Computer II*).

[8]Report and Order, *In re Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Companies*, 95 F.C.C.2d 1117 (1983), *aff'd sub nom. Illinois Bell Tel Co. v. FCC*, 740 F.2d 465 (7th Cir. 1984).

personnel, and different accounting records. The FCC determined that structural separation would make it difficult for the BOCs to cross-subsidize and that it would reduce the chance of access discrimination by putting the BOCs' enhanced service subsidiaries on equal footing with independent enhanced service providers when seeking transmission services.

In 1986, the FCC issued its *Computer III* decision in which it changed its position and ordered that structural separation requirements be eliminated. As we summarized in *California II,*

> The FCC reasoned that the BOCs' divestiture from AT & T and increased market competition had diminished the value of structural separation as a safeguard against monopoly abuse. Moreover, the FCC concluded that the costs of structural separation exceeded its public benefits. Nevertheless, because the FCC found that the BOCs continued to have monopoly power over access to the telephone transmission facilities, the FCC proposed to replace the structural separation requirements with non-structural regulations.

4 F.3d at 1508.

In *California I* we reviewed MCI's challenge to *Computer III.* We summarized petitioners' claims as follows:

> Petitioners claim that it was irrational for the FCC to abandon structural safeguards so soon after imposing them on AT & T in *Computer II* and reimposing them on the divested BOCs. . . . Structural safeguards, argue petitioners, have been the Commission's primary weapon for preventing anticompetitive conduct such as cross-subsidization and discriminatory access, and these safeguards . . . are a long-standing FCC rule

> which was abandoned without a reasoned agency decision.

905 F.2d at 1230.

In *California I* we first determined that the FCC could reasonably have concluded on the record before it that structural separation impeded the development and marketing of some new forms of enhanced services. *Id.* at 1232. We found that the FCC had made a "plausible case" that lifting the structural separation requirement would benefit consumers by permitting the BOCs to operate more efficiently in the enhanced services market *Id.* at 1238.

Second, we concluded that the FCC had also made a "plausible case" that nonstructural safeguards based on the development of new technology, including open network architecture (ONA) and comparably efficient interconnection (CEI), would effectively reduce the risk of BOC access discrimination once the structural separation requirement was lifted. *Id.* at 1233, 1238.

Third, we found that the record did not support the FCC's conclusion that market and technological changes had reduced the danger of cross-subsidization. *Id.* at 1233-38. Accordingly, we held that it was arbitrary and capricious for the FCC to replace structural separation with cost accounting regulations to protect against the harmful effects of cross-subsidization. *Id.* at 1238. We vacated the orders and remanded. However, the FCC entered an order granting waivers of the structural separation requirements; consequently, the BOCs have continued to provide enhanced services on an integrated basis.

In this petition, we must again review the FCC's weighing of the costs and benefits of structural separation.

Standard of Review

Section 10(e) of the Administrative Procedures Act requires a reviewing court to set aside agency action if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C Section 706(2)(A). We must "determine whether the [FCC's] decision was a reasonable exercise of its discretion, based on consideration of relevant factors, and supported by the record." *California I*, 905 F.2d at 1230. The scope of judicial review under this standard is narrow and an agency's interpretation of its own policies and prior orders is entitled to deference. *Id.* Nevertheless, although the standard of review is deferential, it may not be uncritical. *Id.* We therefore may require the agency to provide a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored. *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto Ins. Co.*, 463 U.S. 29, 43-44 (1983) *(State Farm); Office of Communication of United Church of Christ v. FCC*, 707 F.2d 1413, 1425 (D.C. Cir. 1983). Moreover, if the record reveals that the agency has " 'failed to consider an important aspect of the problem' or has 'offered an explanation for its decision that runs counter to the evidence before [it],' " we must find the agency in violation of the APA. *California I*, 905 F.2d at 1230 (quoting *State Farm*, 463 U.S. at 43).

Costs of Structural Separation: The Value of Voice Mail

The principal costs of structural separation in the eyes of the FCC have been the discouragement of innovation, the prevention of efficiency in the packages of services offered consumers, and the duplication of organizations and facilities. One example of discouragement of innovation has been the prevention of the development of the voicemail market for small customers. MCI contends that the FCC placed too much emphasis on the BOCs as the only potential source of

mass market enhanced services and ignored the impact of anticompetitive behavior of the BOCs in preventing competitors from offering enhanced services. MCI further contends that the FCC overemphasized the importance of voice mail, which represents only one in a large array of enhanced services. In *California I*, we were less than laudatory in our assessment of the FCC's analysis of the costs of structural separation and expressed concern that the only concrete example the FCC used to support its cost analysis was voice mail. 905 F.2d at 1232. Nevertheless, we recognized that it was not arbitrary or capricious for the FCC to determine that the inability of the BOCs to develop this market is a substantial cost of structural separation. *See id.* Petitioners have not raised any new claims with regard to the FCC's analysis of the costs of structural separation which would require us to reconsider our conclusion in *California I*. Accordingly, we turn to the FCC's response to our concerns about cross-subsidization.

The Adequacy of the FCC's Response to California I's Decision on Cross-Subsidization

[1] Because the inadequacies of *Computer III* upon which we focused in *California I* dealt with the nonstructural measures relating to cross-subsidization, the FCC on remand directed its primary attention to strengthening the protections against cross-subsidization. On remand, the FCC established additional regulatory safeguards designed to reduce cross-subsidization.

[2] First, the FCC adopted mandatory price cap regulation for the BOCs. Under price caps, a BOC's rates are governed by factors outside of its control, such as the inflation index, rather than by direct costs. Thus, a BOC would have little incentive to shift costs from nonregulated activities to regulated ones because it would not be able to increase regulated rates to recapture those costs. Second,

the FCC established new cost accounting rules that would make cross-subsidization easier to detect. These rules included (1) joint cost rules, which provide that nonregulated enhanced services must contribute to overhead costs of regulated BOC operations, (2) cost allocation manuals, (3) annual audits by independent auditors, in which the auditor must evaluate whether the company's financial statements conform with generally accepted accounting principles, (4) reporting requirements under a new, uniform, detailed, computerized system known as the Automated Reporting and Management Information System, and (5) on-site audits conducted by FCC staff.

MCI argues that the FCC failed to provide record evidence to demonstrate the effectiveness of the accounting safeguards. The FCC counters that price cap regulation and the strengthened cost accounting rules, all of which were adopted after *Computer III*, are sufficient to reduce the danger of cross-subsidization. In addition, the FCC argues that regulators can use the seven BOCs as benchmarks against each other in detecting improper cost-shifting. The FCC acknowledges that it is making a predictive judgment that these measures will be effective, but argues that it is within its authority as a regulatory agency to do so and that it has supported its judgment with reasoned analysis and due consideration of the record.

[3] In *California I*, we concluded that the FCC had unreasonably reversed, without adequate explanation, its previous position that cost-accounting regulations alone would fail to guard against cross-subsidization. *See California I*, 905 F.2d at 1233. We recognized that changes in the telecommunications market, such as development of competing cable and microwave communication systems, could reduce incentives to cross-subsidize. Nonetheless, we rejected the FCC's reliance on changes in the telecommunications market to reduce the danger of cross-subsidization. *See*

id. at 1233-38. On remand, the FCC has taken specific affirmative steps designed to deter and detect cross-subsidization by introducing price caps as well as further strengthening its cost accounting rules. We conclude that with the implementation of these measures, the FCC has responded to our concerns about the weakness of its position in *Computer III* and has demonstrated that the BOCs' incentive and ability to cross-subsidize will be significantly reduced. That the efficacy of these measures has yet to be proven is not in and of itself a basis for finding the FCC's decision arbitrary and capricious. *See, e.g., American Postal Workers Union v. United States Postal Serv.*, 891 F.2d 304, 314 (D.C. Cir. 1989) (noting that "agencies are entitled to engage in predictive judgments" and that " 'complete factual support' is not required where such predictions 'necessarily involve[ ] deductions based on the expert knowledge of the agency' " (quoting *FCC v. National Citizens Comm. for Broadcasting*, 436 U.S. 775, 814 (1978))).

Our conclusion is bolstered by the intervening decision of the D.C. Circuit that considered whether the FCC's new regulations would reduce the danger of cross-subsidization. *United States v. Western Elec. Co.*, 993 F.2d 1572 (D.C. Cir.), *cert. denied*, 114 S. Ct. 487 (1993). The D.C. Circuit concluded that price cap regulation "reduces any BOC's ability to shift costs from unregulated to regulated activities, because the increase in costs for the regulated activity does not automatically cause an increase in the legal rate ceiling." *Id.* at 1580. The court also found that the FCC had "tighten[ed] its accounting rules, especially its treatment of joint costs, all tending to increase the chances of catching any attempts at cost-shifting," *id.* at 1580-81, and that regulators and competitors could use the seven BOCs as benchmarks against each other to detect predatory pricing, *id* at 1580. Finally, the court found that pressure on the BOCs to keep residential service rates low undermined the

theory of regulatory capture on which successful cross-subsidization depends. *Id.* at 1581.

The Implementation of ONA after Computer III

[4] Our review of the validity of the FCC's *Order on Remand* eliminating structural separation requirements has begun with our determination that the FCC has now adequately strengthened the protections against cross-subsidization and therefore has addressed the concerns expressed by this court in *California I.* Our review of this order cannot end with that determination, however. In entering the *Order on Remand*, the FCC was acting not only on the basis of our decision in *California I* but also in the wake of its additional orders regarding open network architecture, ONA. We held in *California II* that the FCC's ONA orders, now integrated into the *Order on Remand*, represented a change in policy from ONA as envisioned in *Computer III.* MCI now contends the changed policy undermines the validity of this order eliminating structural separation because, in light of the policy change, there are no longer adequate safeguards against discrimination in access. It is to that contention that we now turn.

In *Computer III* the FCC ordered the BOCs to develop plans for ONA that would permit enhanced service providers to achieve maximum flexibility in gaining access to telephone transmission facilities thereby allowing them to offer innovative packages of services to consumers. The FCC determined that the open network architecture requirements would be "self-enforcing in controlling discrimination." *Computer III*, 104 F.C.C.2d at 1063.

Computer III anticipated that advances in technology would make it possible to achieve what was termed complete "unbundling" of service components into "building blocks" that would permit the enhanced service providers to construct their own innovative services as easily as the

BOCs. The FCC specified that all basic network capabilities that would be useful in enhanced service applications, "including signaling, switching, billing, and network management" would be subject to the unbundling requirement. *Id.* at 1040. The FCC observed that "[s]uch unbundling is essential to give competing enhanced services providers an opportunity to design offerings that utilize network services in a flexible and economical manner. In essence, competitors will pay only for those Basic Service Elements that they use in providing enhanced services." *Id.* at 1064. This unbundling was intended to permit BOCs' enhanced service competitors to purchase only those elements necessary to a specific type of enhanced service. The network was to be open in order to prevent the BOCs from limiting access, and the unbundled elements were to be tariffed in order to prevent overcharges. *See California II*, 905 F.2d at 1509.

As an interim measure, *Computer III* required the BOCs to establish "comparably efficient interconnection" (CEI) plans so that the BOCs could provide integrated enhanced services pending the unbundling of the networks. The BOCs had to file CEI plans for each enhanced service the BOCs offered. The CEI plans ensured that enhanced service competitors were provided with interconnections to the BOCs' own networks that were substantially equivalent to the interconnections that the BOCs provided for their own enhanced services. CEI, in contrast to ONA, was limited to offering the competitors only the interconnections for enhanced services that the BOCs themselves already offered. CEI does not allow competitors to pick and choose building blocks to create their own enhanced services. *See California II*, 905 F.2d at 1511.

In *California I* we accepted the FCC's assessment that, because of ONA, structural separation was no longer required to prevent access discrimination. We observed that the network access policies that the FCC planned to substi-

tute for structural separation depended on the development of new technologies.

> The FCC's policy of Comparably Efficient Interconnection (CEI) is designed to ensure that each BOC will provide competitors with connections to the local exchange that equal the connections available to the BOCs' own enhanced services offerings. Moreover, the Open Network Architecture (ONA) policy requires each BOC to incorporate CEI concepts into the overall design of its basic service network. Thus, the record supports the Commission's finding that technologies for ensuring equal access have improved, and may be effective in preventing discrimination in ways not feasible in the past.

California I, 905 F.2d at 1233.

The BOCs were required to file open network architecture plans by 1988; approval of such plans was a precondition to the removal of structural separation. As the FCC said in *Computer III:*

> After implementation of an approved Open Network Architecture Plan and the carrier's satisfaction of our cost allocation and other safeguards, the structural separation requirements will no longer apply to the carrier's enhanced services operations, and it will not be required to file a service-specific CEI plan prior to offering a new enhanced service.

Computer III, 104 F.C.C.2d at 1067-68.

Beginning in 1988, the FCC filed a series of orders reviewing the ONA plans that the BOCs submitted.[9] It is these orders implementing ONA that we reviewed in *Cali-*

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[9]*See supra* note 3.

fornia II. We concluded that they constituted a retreat from the original promise of *Computer III*.

In *California II* we reviewed MCI's claim that, in approving the ONA plans, the FCC had significantly altered, without reasoned justification, the scope and purpose of ONA as articulated in *Computer III*. 4 F.3d at 1510-11. We rejected the FCC's claim that ONA had always been intended to be an evolutionary process. *Id.* at 1511. We agreed with MCI that because the ONA plans as approved did not accomplish fundamental unbundling, the FCC's approval of these plans constituted a change from its position that complete ONA was a prerequisite to the elimination of structural separation. We stated. "[t]he orders before us represent a change from the FCC's earlier view in *Computer III* that complete ONA would precede lifting structural separation. These orders advance the view that structural separation can be lifted before the implementation of a fully realized ONA." *Id.* at 1513. We did not, however, set aside the orders implementing ONA because those orders did not themselves lift structural separation or explain the conditions under which structural separation, after *California I*, could be lifted. The *Order on Remand* does lift structural separation, and we must consider whether it adequately explains why fully implemented ONA is no longer regarded as a necessary safeguard against access discrimination after removal of structural separation.

In a companion order to the *Order on Remand*, the FCC conditionally approved ONA plans filed by the BOCs.[10] In this order, as in the ONA orders reviewed in *California II*, the FCC reaffirmed its view that ONA will be an evolutionary process. In line with this policy shift, the approved ONA plans do not offer full deployment of ONA services and are

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[10]*In the Matter of Filing and Review of Open Network Architecture Plans*, CC Docket No. 88-2, Phase 1 (1991).

not based on new technology. In the *Order on Remand*, the FCC recognized that it no longer requires fundamental unbundling of the BOC networks as a precondition to lifting structural separation. "[T]he Commission declined to require a radical reconfiguration or fundamental unbundling of the BOC networks, stating that providing ONA based on a more disaggregated and at that time unspecified architecture would be extremely costly and unnecessary for effective implementation of ONA." *Order on Remand*, 6 F.C.C.R. at 7600-01.

In support of its claim that the nonstructural safeguards currently regarded as adequate by the FCC will not prevent access discrimination, MCI argues that the record contains evidence of access discrimination by the BOCs in the provision of enhanced services. MCI relies heavily on the decision of the Georgia Public Service Commission (Georgia PSC) in its investigation into BellSouth's provision of MemoryCall Service. Order of the Commission, *In the Matter of the Commission's Investigation into Southern Bell Telephone and Telegraph Company's Trial Provision of MemoryCall Service*, Docket No. 4000-U (Ga. PSC June 4, 1991). The Georgia PSC authorized BellSouth to provide an intrastate voice-messaging system, known as MemoryCall, to limited markets on a trial basis. After conducting an investigation into the provision of MemoryCall, the Georgia PSC concluded that BellSouth had the opportunity and incentive to behave anticompetitively given its monopoly over the local exchange and had in fact discriminated against competitor enhanced service providers by giving them inferior access to the local network. The Georgia PSC found that the record demonstrated at least three significant instances of discriminatory behavior by BellSouth. The Georgia PSC found that: (1) because of technical barriers to independent enhanced service providers' use of the local networks, competitors could only provide a voice-messaging service that was significantly inferior to MemoryCall;

(2) BellSouth had refused to allow competitors to co-locate their equipment in BellSouth's central offices, resulting in quality and price disadvantages for competitors; and (3) BellSouth had manipulated development of the local network, especially the timing of the unbundling of certain network features necessary for voice-messaging services, in order to maximize its competitive advantage for its initial offering of MemoryCall. *Id.* at 27-34.

The FCC responds that the MemoryCall case does not show that its safeguards are ineffective because, among other reasons, ONA had not yet been implemented at that time. The problem with this argument is that ONA, at least as defined in *Computer III*, still has not been achieved. The MemoryCall case shows that the BOCs have the incentive to discriminate and the ability to exploit their monopoly control over the local networks to frustrate regulators' attempts to prevent anticompetitive behavior. The FCC has not explained adequately how its diluted version of ONA will prevent this behavior.

The FCC contends that ONA is merely one component of its overall regulatory scheme designed to prevent access discrimination. The FCC points to the other safeguards against access discrimination it has established, including CEI, nondiscrimination reporting requirements and network disclosure rules. The FCC contends that even without fully implemented ONA, these safeguards will prevent access discrimination. The problem with this argument is that the FCC ruled to the contrary in *Computer III* and has not explained, in its *Order on Remand* or elsewhere in its formal rulings, why the conclusion it reached in *Computer III* regarding ONA has changed.

Under CEI, the BOCs must provide other enhanced service providers the same interconnections the BOCs use in providing their own services. The nondiscrimination reporting requirements are designed to allow the FCC to deter-

mine whether the BOCs are providing the same quality of service to competitors as used in the BOCs' own enhanced services. The network disclosure rules provide that the BOCs must give notice to competitors of new or modified network services affecting interconnection for enhanced services.

While CEI and the nondiscrimination reporting requirements are designed to prevent BOC discrimination against other enhanced service providers where a BOC is providing its own enhanced service, these safeguards do not enable enhanced service providers to pick and choose network service elements to design and develop enhanced services. Consequently, competitors who otherwise would be able to compete effectively by offering more efficient packages of services had fundamental unbundling been accomplished might be excluded from the market entirely. Further, the network disclosure rules do not guarantee that the BOCs will provide competitors with the interconnection they need for their enhanced services. Thus, according to the analysis of the FCC in *Computer III*, these safeguards are not a substitute for ONA and, without ONA, are not adequate to prevent access discrimination. If there conclusions no longer hold, the FCC has not explained why.

[5] In our view, the FCC in the *Order on Remand*, as in its orders implementing ONA, has changed its requirements for, or definition of, ONA so that ONA no longer contemplates fundamental unbundling. Yet in *Computer III* the FCC regarded that fundamental unbundling as a key safeguard against access discrimination. In the *Order on Remand*, the FCC never explains why it now authorizes lifting structural separation when it recognizes that its assumptions in *Computer III* regarding ONA have not proven correct, and that fundamental unbundling is not attainable at this time. In *Computer III*, the FCC concluded that ONA, based on new technology to permit fundamental unbundling,

would be a key nonstructural safeguard in preventing access discrimination as effectively as structural separation. Relying on this conclusion, the FCC determined that the benefit of maintaining structural separation to prevent discrimination was minimal. Now that fundamental unbundling is no longer regarded as attainable, the FCC should have adjusted its cost benefit analysis accordingly. It has not done so.

[6] In *California I*, we held that because the FCC had not supported its conclusions regarding prevention of cross-subsidization, the FCC's overall cost benefit analysis was flawed and its order was arbitrary and capricious under the APA. 905 F.2d at 1238. Here, the FCC has similarly failed to provide support or explanation for some of its material conclusions regarding prevention of access discrimination. Thus, once again, we conclude that the FCC's cost benefit analysis is flawed and set aside the *Order on Remand* as arbitrary and capricious under the APA.

Customer Proprietary Network Information

[7] Collateral to its renewed attacks on the FCC's cost benefit analysis, MCI also challenges the provision in the *Order on Remand* that deals with Customer Proprietary Network Information (CPNI).

CPNI is information about a telephone customer's use of the telephone network, such as the number of lines ordered, service location, type and class of services purchased, usage levels, and calling patterns. This information is generated by the BOCs in their provision of basic telecommunications services. CPNI is useful to the BOCs and competitor enhanced service providers in their development and marketing of enhanced services because it can assist them in identifying potential customers, designing more efficient services, and better meeting customer needs. Customers, however, have proprietary and privacy interests in their

CPNI and for this reason may seek to restrict access to their CPNI. *Order on Remand*, 6 F.C.C.R. at 7607, 7611.

In *Computer III*, the FCC adopted rules governing access to CPNI. These rules allowed the BOCs, including BOC enhanced services personnel, unrestricted access to the CPNI of BOC telephone customers unless the customer requested confidentiality. Customers, however, were not notified of their option to request confidentiality, so for the most part the BOCs had unrestricted access to CPNI by default. Independent enhanced service providers, however, were required to obtain prior authorization from customers for access to CPNI.

In the *Order on Remand*, the FCC strengthened the rules governing access to CPNI to protect customer confidentiality and to eliminate, in part, the BOCs' previous advantage. The FCC ordered that for customers with more than 20 lines, both the BOCs and competitors must obtain prior customer authorization for access to CPNI. For small customers, defined as those having 20 lines or less, the rules remain the same. Thus, the BOCs shall have access to CPNI of small customers unless the customer requests confidentiality, but independent enhanced service providers must obtain prior customer authorization before they can obtain CPNI for small customers.

[8] The FCC's strengthened CPNI rules provide more competitive equity to MCI than the previous rules under *Computer III*, which were not challenged in *California I*. It is not clear why the CPNI rules are challenged for the first time in this petition. We conclude that the new CPNI rules set forth in this order are not arbitrary and capricious.

MCI challenges the new rules as irrational, largely because they are "asymmetrical." The new CPNI rules allow MCI to compete with the BOCs on an equal basis with respect to large customers, whose CPNI is more competi-

tively valuable. At the same time, the asymmetric rule for small customers recognizes that the BOCs are uniquely situated to develop the market for small customers. The FCC found that BOC access to CPNI is justified because it allows customers the benefit of one-stop shopping which is important to the development of a mass market in enhanced services. The FCC found that the BOCs are uniquely positioned to reach small customers, and that it would be economically infeasible to develop a mass market for enhanced services if prior authorization was required for access to CPNI. If small customers are required to take an affirmative step of authorizing access to their information, they are unlikely to exercise this option and thereby impair the development of the mass market for enhanced services in the small customer market.

In adopting the new CPNI rules, the FCC balanced the competing interests of competitive equity, customer privacy, and the need for efficiency in the development of mass market enhanced services. We conclude that the FCC's balancing of these interests was not arbitrary and capricious.

III. PREEMPTION

The Communications Act of 1934, 47 U.S.C. §§ 151-613, separates interstate and intrastate jurisdiction to regulate telecommunications. The FCC has authority under the Act to regulate "interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States, a rapid, efficient Nationwide and world-wide wire and radio communication service." 47 U.S.C. § 151. At the same time, however, the Act in § 2(b)(1) denies the FCC authority over intrastate communications. That section provides in pertinent part:

> [N]othing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to

> (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . . .

47 U.S.C. § 152(b)(1).

In *Computer III*, the FCC issued orders preempting nearly all state regulation of enhanced services by communications common carriers, including state tariffing of enhanced services, structural separation requirements and nonstructural safeguards inconsistent with or more stringent than the FCC's nonstructural safeguards. *See California I*, 905 F.2d at 1239. The preemption was clearly broad enough to cover regulation of the provision of enhanced services on both an intrastate and interstate basis. Petitioners in that case contended that the preemption violated § 2(b)(1) by ousting the states of jurisdiction Congress had granted them.

In *California I* we looked to the FCC's argument that the preemption in that case was valid because the state regulations could not feasibly coexist with the *Computer III* scheme. 905 F.2d at 1242-1243. We agreed with the Commission that the Supreme Court's decision in *Louisiana Public Service Commission v. FCC*, 476 U.S. 355 (1986), recognizes an "impossibility" exception to Section 2(b)(1). We quoted with approval the D.C. Circuit's decision in *National Ass'n of Regulatory Util. Comm'rs v. FCC*, 880 F.2d 422, 429 (D.C. Cir. 1989), that the only limitation on a state's authority over intrastate telephone service is "when the state's exercise of that authority negates the exercise by the FCC of its own lawful authority over interstate communication." *California I* at 1243.

We went on to recognize, however, that the impossibility exception is narrow, and that the FCC has the burden of showing that the state regulation would negate valid FCC regulatory goals. We held that the FCC had not justified the

broad preemption provisions of *Computer III*, and we therefore remanded. *Id.* at 1244.

On remand, the FCC acknowledged that "[p]reemption of state regulation in this area should be as narrow as possible to accommodate differing state views while preserving federal goals." *Order on Remand*, 6 F.C.C.R. at 7631. Consequently, the FCC issued a preemption order that was narrower than the order it issued in *Computer III*. First, with regard to structural separation, the FCC preempted only state requirements for structural separation of facilities and personnel used to provide the intrastate portion of jurisdictionally mixed enhanced services. The FCC did not preempt state regulations that require a separate corporate entity with separate books of account for provision of such services. The FCC also declined to preempt any state structural separation requirements with respect to enhanced services that are offered on a purely intrastate basis. Second, the FCC preempted state CPNI regulations that require prior authorization inconsistent with that required in the *Order on Remand*. Third, the FCC preempted state rules that require initial disclosure of network changes at a different time than the network disclosure rules in the *Order on Remand*.

In its petition for review to this court, New York's principal contention is that the FCC may preempt state action only when it is acting pursuant to specified regulatory duties under Title II of the Act, such as setting tariffs. It contends that in this case, the FCC's action is intended to implement the more general goals of Title I and hence no preemption authority exists under *Louisiana*.

This position must be rejected. The Supreme Court's opinion in *Louisiana* is not so narrowly restricted. Although the Court discussed a Title II function in the paragraph to which it appended the footnote that suggested the 'impossibility' exception, *see Louisiana*, 476 U.S. at 375 & n.4, we do not ascribe any significance to this placement. The

argument that the Court made with respect to Title I on the preceding page, that section 152(b) of the Act "constitutes . . . a congressional *denial* of power to the FCC" to regulate, *id.* at 374, applied to Title II as well as Title I. We recognized in *California I*, moreover, that the impossibility exception applied to FCC preemption action designed to achieve the same regulatory goals it seeks to achieve here. 905 F.2d at 1243. Indeed, we noted specifically that the FCC acted pursuant to Title I of the Act. *See id.* at 1240-41 n.35. The difficulty with *Computer III* was the FCC's failure to justify the breadth of the preemption in that order, not its jurisdiction to order any preemption.

The only remaining question, raised by California and other intervening states, is whether the FCC has indeed justified the extent of its preemption as sufficiently narrowly tailored under the impossibility exception. On remand, the FCC preempted state regulations requiring separate facilities and personnel for the intrastate portion of enhanced services that are offered both interstate and intrastate. The FCC determined that it would not be economically feasible for the BOCs to offer the interstate portion of such services on an integrated basis while maintaining separate facilities and personnel for the intrastate portion. Thus, the FCC concluded, the BOCs would opt to comply with state requirements and provide such services entirely on a structurally separated basis.

[9] The FCC has presented adequate record support for its conclusion that because of economic and operational factors, enhanced service providers would separate their facilities for services that are offered both interstate and intrastate, thereby essentially negating the FCC's goal of allowing integrated provision of enhanced and basic services. We agree with the FCC that the situation presented here is similar to that presented in *North Carolina Utils. Comm'n v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027

(1976), and *North Carolina Utils. Comm'n v. FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) (the *NCUC* cases), which were the cases that the *Louisiana* Court suggested would warrant application of an impossibility exception. 476 U.S. at 375 n.4. In the *NCUC* cases, the Fourth Circuit upheld the FCC's preemption of state regulations barring the use of customer provided telephone equipment for intrastate service, because they conflicted with the FCC's regulations allowing customers to provide their own telephones for interstate service. The Fourth Circuit acknowledged that it was possible to comply with both the states' and the FCC's regulations: customers could have one telephone for interstate use and one for intrastate use. The court nevertheless agreed with the FCC that it was highly unlikely, due to practical and economic considerations, that customers would maintain two separate phones and, therefore, that customers would use telephone company equipment to comply with state regulations. *NCUC*, 552 F.2d at 1043. Because the state regulations would effectively negate the FCC's regulation authorizing the use of customer provided equipment for interstate services, the Fourth Circuit upheld the FCC's preemption. *Id.*

[10] Here, as in the *NCUC* cases, the FCC acknowledges that the BOCs could comply with structural separation requirements, but contends that it would not be economically or operationally feasible for them to do so. The BOCs would be forced to comply with the state's more stringent requirements, or choose not to offer certain enhanced services, thereby defeating the FCC's more permissive policy of integration. We conclude that the impossibility exception, as applied in the *NCUC* cases, authorizes the FCC's preemption of state structural separation requirements here.

[11] We also affirm the FCC's preemption of state regulations regarding CPNI and network disclosure rules. The FCC has shown that conflicting state rules regarding

access to CPNI would negate the FCC's goal of allowing the BOCs to develop efficiently a mass market for enhanced services for small customers. The FCC has also demonstrated that compliance with conflicting state and federal network disclosure rules would in effect be impossible.

[12] In sum, the FCC's order adequately responds to our directive that "the FCC bears the burden of justifying its *entire* preemption order by demonstrating that the order is narrowly tailored to preempt *only* such state regulations as would negate valid FCC regulatory goals." *See California I*, 905 F.2d at 1243. The FCC has met its burden of showing that its regulatory goals of authorizing integration of services would be negated by the state regulations it has preempted. We therefore conclude that the FCC has satisfied our concerns expressed in *California I* and that the preemption aspects of the *Order on Remand* should be upheld.

IV. CONCLUSION

On our review of the *Order on Remand*, we conclude that the FCC's nonstructural safeguards against cross-subsidization adequately respond to our concerns in *California I*, but that the FCC has failed to explain or justify its change in policy regarding nonstructural safeguards against access discrimination. For this reason, the FCC's cost benefit analysis is flawed and that portion of its order is arbitrary and capricious. We uphold those portions of the *Order on Remand* that implement CPNI rules and that preempt state regulations.

WE GRANT THE PETITION FOR REVIEW, VACATE IN PART THE ORDER ON REVIEW, AND REMAND TO THE COMMISSION FOR FURTHER PROCEEDINGS CONSISTENT WITH THIS OPINION.

APPENDIX B

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FCC 91-381
37281

In the Matter of *Computer III* Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards	CC Docket No. 90-623

REPORT AND ORDER

Adopted: November 21, 1991

Released: December 20, 1991

By the Commission: Commissioner Duggan issuing a statement.

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I. *Introduction*

1. In this *Report and Order*, we reverse our determination in *Computer II* and the *BOC Separation Order* to impose structural separation requirements for the provision of enhanced services by the Bell Operating Companies (BOCs). In place of structural separation, we adopt effective regulatory safeguards that will permit the BOCs to provide enhanced services to the public in ways that will best further the public interest and serve American consumers. After close examination, we decline to preempt all the state regulation preempted in *Computer III*, but do preempt

certain forms of state regulation that would thwart or impede federal objectives.

2. A technologically innovative and economically efficient telecommunications infrastructure is central to continued United States prominence in an increasingly information-oriented global economy. We should remove unnecessary regulatory barriers that impede the responsiveness of American companies to marketplace incentives that foster increasing use and advancement of the nations's telecommunications assets. At the same time, it is critical to the development of full and fair competition to establish and maintain effective regulatory safeguards against anticompetitive conduct by regulated communications common carriers when they seek to participate in the enhanced services industry. Further, this Commission has a duty under the Communications Act to protect regulated service ratepayers by guarding against cross-subsidy between basic and enhanced services. We initiated this proceeding in response to the Ninth Circuit's decision in *California v. FCC*, which vacated three *Computer III* orders.

II. *Background*

3. In *Computer II* the Commission determined that enhanced services and customer premises equipment (CPE) should not be provided as tariffed services pursuant to Title II of the Communications Act, and established rules to govern the participation of telecommunications common carriers in those activities.[1] The Commission required

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[1]Amendment of Section 64.702 of the Commission's Rules and Regulations (*Computer II*), 77 FCC 2d 384, 428-430, paras. 114-118 (1980) (*Final Decision*), *modified on recon.*, 84 FCC 2d 50 (1981) (*Reconsideration Order*), *modified on further recon.*, 88 FCC 2d 512 (1981) (*Further Reconsideration Order*); *affirmed sub nom.*, Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

AT&T to establish subsidiaries for enhanced services and CPE that were fully separated from all of AT&T's common carrier operations.[2] After the United States District Court for the District of Columbia adopted the Modification of Final Judgment (MFJ),[3] which resulted in the divestiture by AT&T of the BOCs, the Commission adopted an order requiring the BOCs to adhere to the structural separation requirements for CPE and enhanced services that *Computer II* had imposed upon the predivestiture AT&T. The Commission committed to review those requirements in two years.[4]

4. More than two years after the divestiture occurred, the Commission re-examined the *Computer II* separate subsidiary requirements in light of the changes in the industry and the difficulties that the requirements had created for the day-to-day operations of the affected companies. In a series of orders, the Commission removed the CPE and the enhanced service separation requirements for both AT&T and the BOCs. The enhanced service separate subsidiary requirements were replaced with a regime of Open Network Architecture (ONA) requirements and accounting and other nonstructural safeguards. Although re-

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[2]*Final Decision*, 77 FCC 2d at 475-486, paras. 233-260; *Reconsideration Order*, 84 FCC 2d at 75-86, paras. 72-105; 47 C.F.R. § 64.702.

[3]United States v. AT&T, 552 F.Supp. 131 (D.D.C. 1982), *affirmed sub nom.*, Maryland v. United States, 460 U.S. 1001 (1983).

[4]Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Equipment by the Bell Operating Companies, CC Docket No, 83-115, *Report and Order*, 95 FCC 2d 1117, 1120, para. 3 (1984) (*BOC Separation Order*), *affirmed sub nom.* Illinois Bell Telephone Co. v. FCC, 740 F.2d 465 (1984), *affirmed on recon.*, FCC 84-252, 49 Fed. Reg. 26056 (1984) (*BOC Separation Reconsideration Order*), *affirmed sub nom.*, North American Telecommunications Association v. FCC, 772 F.2d 1282 (7th Cir. 1985).

moval of AT&T separation requirements and BOC CPE separation requirements were not challenged, the decision to permit the BOCs to provide enhanced services on an integrated basis provoked appeals that led to an opinion by the Court of Appeals for the Ninth Circuit, which vacated three orders in the *Computer III* proceeding.[5] The Court of Appeals concluded that the Commission decision to rely on nonstructural safeguards in lieu of structural separation to protect against cross-subsidization of enhanced services by the BOCs had not been adequately justified when adopted.[6] The Court noted, however, that the Commission could have justified its decision on the grounds "that the national interest in allowing the BOCs to compete more efficiently in the enhanced services industry justified reduced regulatory protection against cross-subsidization," but stated that "this is not the case before us."[7]

5. The Commission subsequently issued a *Notice* in this remand proceeding, proposing to permit the BOCs to provide enhanced services pursuant to a strengthened set of nonstructural safeguards that would effectively protect

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[5]Amendment of Sections 64.702 of the Commission's Rules and Regulations, (*Computer III*), CC Docket No. 85-229, Phase I, *Report and Order*, 104 FCC 2d 958 (1986) (*Phase I Order*), *recon.*, 2 FCC Rcd 3035 (1987), (*Phase I Reconsideration Order*), *further recon.*, 3 FCC Rcd 1135 (1988) (*Phase I Further Reconsideration Order*), *second further recon.*, 4 FCC Rcd 5927 (1989) (*Phase I Second Further Reconsideration Order*), *Phase I Order* and *Phase I Reconsideration Order vacated sub nom.*, California v. FCC, 905 F.2d 1217 (9th Cir. 1990) (*California*); Phase II, CC Docket No. 85-229, 2 FCC Rcd 3072 (1987) (*Phase II Order*), *recon.*, 3 FCC Rcd 1150 (1988) (*Phase II Reconsideration Order*), *further recon.*, 4 FCC Rcd 5927 (1989) (*Phase II Further Reconsideration Order*), *Phase II Order vacated sub nom.*, California v. FCC, 905 F.2d 1217 (9th Cir. 1990), *pet. for rev. pending*, BellSouth Corp. v. FCC (9th Cir. No. 88-7290, filed April 20, 1988).

[6]California v. FCC, 905 F.2d 1217 (1990) (*California*).

[7]*Id.* at 1238-1239.

against cross-subsidization and discrimination, while furthering the Commission's goals of a technologically innovative and economically efficient telecommunications infrastructure. The *Notice* also proposed to preempt only those state regulations differing from federal safeguards that would thwart or impede federal policy, such as permitting the integrated provision of interstate basic and enhanced services by the BOCs, AT&T, and the independent telephone companies (independents).[8] The *Notice* granted an interim waiver to the BOCs to permit them to provide enhanced services pursuant to previously approved Comparably Efficient Interconnection (CEI) plans pending the completion of this proceeding.[9]

III. *Regulatory Safeguards Governing BOC Provision of Enhanced Services*

6. A regulatory framework that permits the BOCs to provide enhanced services pursuant to safeguards that will both effectively protect against cross-subsidization and discrimination and encourage efficient use of BOC resources to provide enhanced services will best serve the public interest. Eliminating all structural separation requirements and allowing the BOCs to provide enhanced services pursuant to nonstructural safeguards will permit the BOCs to realize fully their vast potential to provide enhanced services to the public, especially to the consumer market. Removal of structural separation requirements will permit the BOCs to use their extensive resources, including geographically dispersed facilities and the associated management and opera-

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[8]Computer III Remand Proceedings: Bell Operating Safeguards; and Tier 1 Local Exchange Company Safeguards, *Notice of Proposed Rulemaking and Order*, CC Docket No. 90-623, 6 FCC Rcd 174 (1990) (*Notice*).

[9]A list of parties filing comments and replies is contained in Appendix A.

tional resources, to provide a variety of enhanced services throughout the country. Such an approach will permit the BOCs to use existing marketing contacts with virtually every household within their regions to market enhanced services to consumers inexpensively, to use the same personnel to repair and install the services and equipment necessary to provide basic and enhanced services, and to use their expertise to engage in research and development for enhanced services.

7. Our experience over the last ten years demonstrates that removal of structural separation requirements has resulted and will result in greater BOC participation in the provision of enhanced services. Under the nonstructural safeguards in place through CEI plans and market trials, the BOCs have provided voice mail service, E-mail, gateways, electronic data interchange, data processing, voice store-and-forward, and fax store-and-forward services. The BOCs' provision of voice mail services is particularly significant. In the relatively brief time that the BOCs have been permitted to provide that service, voice mail has been provided to rapidly increasing numbers of customers in their regions at reasonable prices.

8. By contrast, our experience with structural separation shows that it inhibits BOC provision of enhanced services. Under structural separation, the BOCs provided few enhanced services, and structural separation apparently completely foreclosed BOC provision of voice mail service.[10] Essentially, structural separation prevents the BOCs from using their existing substantial resources to provide enhanced services, requiring instead separation and/or duplication of facilities and personnel to provide both enhanced

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[10]American Telephone and Telegraph Co. Petition for Waiver of Section 64.702 of the Commission's Rules and Regulations, 88 FCC 2d 1 (1981) (*Custom Calling Denial Order*).

and basic services. It imposes direct monetary costs, and results in loss of efficiencies and economies of scope. The BOCs have submitted significant evidence of the financial and operational efficiencies that would be lost under structural separation. Costs for voice mail services could be up to 68% higher under structural separation necessitating price increases of up to 30% and 80%.

9. We also conclude that the use of our comprehensive set of strengthened nonstructural safeguards instead of structural separation will not result in significant public interest costs. Some commenters claim that a major cost of nonstructural safeguards is that they will be ineffective to protect against anticompetitive conduct by the BOCs in the enhanced services marketplace. As we explain fully below, we have adopted and implemented a comprehensive regulatory framework that provides an effective alternative to structural separation for protection against anticompetitive conduct. To the extent nonstructural safeguards may involve any small diminution in protection against anticompetitive conduct as compared with a structural separation requirement, we conclude that it is outweighed by the substantial benefits of nonstructural safeguards.

10. The *California* Court did not find fault with our determination in *Computer III* that there could be significant public interest benefits from use of nonstructural safeguards. It vacated *Computer III* in its entirety because it concluded that the Commission had not presented sufficient justification for reliance on cost accounting safeguards so soon after the Commission's decision in the *BOC Separation Order* to continue structural separation for BOC enhanced services operations. In response to the Court's concerns, we first address the proposals in the *Notice*, and adopt a strengthened set of cost accounting safeguards. We then determine that these modified cost accounting safeguards, given our experience with cost accounting safeguards since

the *BOC Separation Order* and *Computer III*, constitute an effective alternative to structural separation to protect against cross-subsidy. Further, we adopt various safeguards against discrimination, including: (1) network disclosure rules; (2) nondiscrimination reporting requirements; and (3) revised customer proprietary network information (CPNI) rules. We conclude that these requirements, along with ONA, are an effective alternative to structural separation to guard against anticompetitive conduct by the BOCs affecting the enhanced services marketplace.

11. Having identified a comprehensive set of nonstructural safeguards to protect against cross-subsidization and discrimination, we then assess, in Section D. below, the benefits of eliminating structural separation. We conclude, as indicated, that there are substantial benefits from use of nonstructural safeguards and no significant costs. We therefore permit the BOCs to provide enhanced services pursuant to those nonstructural safeguards instead of the *Computer II* regime of structural separation. We also undertake to review, after three years of a fully effective ONA environment, the working of nonstructural safeguards in light of marketplace developments.

A. *Safeguards against Cross-Subsidization*

12. In the *Notice*, the Commission evaluated regulatory developments since the *BOC Separation Order* and tentatively concluded that they have reduced the ability of the BOCs to engage in improper cross-subsidization of their enhanced service operations, as well as their incentives to do so. These regulatory developments were the adoption and implementation of detailed cost allocation rules and related cost accounting safeguards that separate nonregulated ser-

vice costs from regulated service costs,[11] the implementation of cost accounting mechanisms to enforce the joint cost rules including the filing and approval of cost allocation manuals, the requirement that carriers submit to independent audits, and the establishment of the Automated Reporting and Management Information System (ARMIS).[12] The Commission also stated that the adoption of price cap regulation for the local exchange carriers (LECs) could, along with cost allocation, reporting, and enforcement safeguards, reduce BOC incentives to cross-subsidize.[13] The Commission observed that its enforcement mechanisms had resulted in vigorous enforcement actions in several instances to assure that improper cross-subsidization did not occur.[14] In addition to these regulatory developments, however, the Commission proposed to strengthen in five ways its existing cost accounting safeguards applicable to the BOCs and other Tier 1 LECs. The Commission stated that these measures would provide regulated ratepayers and the BOCs' (and other Tier 1 LECs') competitors with important additional protections against cross-subsidization. The Commis-

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[11]Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities & Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and Their Affiliates, CC Docket No. 86-111, 2 FCC Rcd 1298, 1329-1331 (1987) (*Joint Cost Order*), *recon.* 2 FCC Rcd 6283 (1987) (*Joint Cost Reconsideration Order*), *further recon.*, 3 FCC Rcd 6701 (1988) (*Joint Cost Further Reconsideration Order*), *affirmed sub nom.*, Southwestern Bell Corporation v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

[12]Automated Reporting Requirements for Certain Class A and Tier 1 Telephone Companies (Parts 31, 43, 67, and 69 of the FCC's Rules), 2 FCC Rcd 5770 (1987) (*ARMIS Order*), *recon.*, 3 FCC Rcd 6375 (1988).

[13]*Notice*, 6 FCC Rcd at 178, para. 25.

[14]*Id.* at 177-178, paras. 18-23.

sion tentatively concluded that its existing and proposed cost accounting safeguards would effectively protect ratepayers and others from cross-subsidization and the effects thereof, and that structural separation is not necessary to protect against cross-subsidization.

13. In this *Report and Order*, we determine that our existing cost accounting safeguards and those proposed in the *Notice* constitute a realistic and reliable alternative to structural separation to protect against cross-subsidy. These cost accounting safeguards, along with our safeguards against discrimination, will permit realization of the public interest benefits of integrated provision by the BOCs of basic and enhanced services without creating substantial risks of cross-subsidization in comparison to structural separation. We also determine that the adoption of price cap regulation for the LECs constitutes an effective complement to cost allocation, reporting, and enforcement safeguards, to reduce BOC incentives to cross-subsidize.[15] We address first adoption of the strengthened cost accounting safeguards proposed in the Notice and then address the effectiveness of these cost accounting safeguards to protect against cross-subsidization.

1. *Adoption of Strengthened Cost Accounting Safeguards*

14. The *Notice* proposed, in addition to the panoply of existing cost accounting, reporting, and enforcement safeguards, that: (1) LECs treat enhanced services as nonregulated activities for accounting and jurisdictional separations purposes; (2) independent auditors provide the same level of assurance in audits conducted pursuant to the joint cost rules as that undertaken in a financial statement audit engagement; (3) the Common Carrier Bureau study means

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[15] *Id.* at 178, para. 25.

of achieving greater uniformity in the carriers' cost allocation manuals and, if appropriate, take steps necessary to accomplish this goal; (4) carriers quantify the effects of cost allocation manual changes when such changes are submitted to the Commission; and (5) the Bureau study whether to establish a reasonable threshold for determining the materiality of errors and omissions discovered in the independent audits of carrier filings, and, if appropriate, take steps necessary to implement such a threshold.[16] We address these proposals in turn.

a. Nonregulated Treatment of Enhanced Services for Federal Accounting and Jurisdictional Separations Purposes

15. The first accounting proposal involves continued nonregulated treatment of enhanced services for accounting and cost allocation purposes. Under such treatment, the costs of nonregulated activities are removed from the carriers' prescribed Part 32 accounts prior to the jurisdictional separations process.

16. *Comments.* Our proposal to require carriers to treat enhanced services as nonregulated activities for accounting and jurisdictional separations purposes is supported by virtually all of the LECs commenting on this issue, as well as by a trade association of equipment manufacturers.[17] The LECs commend the proposal as an effective measure to ensure that interstate ratepayers do not bear costs associated with enhanced services.[18] They state that continued treatment of enhanced services as nonregulated activities will allow carriers to utilize their existing accounting systems

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[16]*Notice*, 6 FCC Rcd at 178, para. 26.

[17]CBEMA Comments at 6.

[18]USTA Comments at 6; Ameritech Comments at 15-16; NYNEX Comments at 35; Pacific Comments at 39; U S West Comments at 102.

and will enable the Commission to achieve its policy goals without adversely affecting the rights of the states.[19] The LECs contend that subjecting enhanced service costs to jurisdictional separations would be unnecessary, difficult to administer and audit, and require costly modifications to the Commission's cost allocation process and access charge rules, the carriers' internal accounting systems, and ARMIS, the Commission's Automated Reporting Management Information System.[20]

17. The majority of comments filed in this proceeding by states, state agencies and commissions, and their representatives do not address this question.[21] One state commission, the Michigan PSC, support [sic] continued nonregulated treatment of enhanced services.[22] On the other hand, the Southwest Regional Regulatory Group (SWRRG) representing five state commissions, objects to the proposal, arguing that its adoption would constitute unwarranted preemption of state regulation of a number of enhanced services that are "solely intrastate or local in their use of the network."[23] The California PUC further argues that Sec-

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[19]BellSouth Comments at 19; Bell Atlantic Comments at 19. *See also* USTA Comments at 6-7; Ameritech Comments at 17; Pacific Comments at 39-40; SNET Comments at 10.

[20]USTA Comments at 6-7; Ameritech Comments at 15-17; Pacific Comments at 39-40; BellSouth Comments at 19; Cincinnati Bell Comments at 3; SNET Comments at 10.

[21]Colorado Public Utilities Commission, Florida Public Service Commission, Hawaii, Illinois Commerce Commission, New York Public Service Commission, Oregon Public Utilities Commission, Pennsylvania Office of Consumer Advocate, Vermont Department of Public Service, Washington Utilities and Transportation Commission, National Association of Regulatory Utility Commissioners.

[22]Michigan PSC Comments at 6-7.

[23]SWRRG Comments at 9. The Southwest Regional Regulatory Group includes the Arkansas Public Service Commission, Kansas Com-

tion 410(c) of the Communications Act compels the Commission to apportion enhanced service costs between the federal and state jurisdictions.[24] Finally, the District of Columbia PSC contends that the proposal shifts cost allocation problems for enhanced services from this Commission to the state commissions. In reply, NYNEX states that our proposal should not affect state regulation of enhanced services because states regulating rates for enhanced services could consider the total fully allocated enhanced service costs and thereby prevent cross-subsidization.[25]

18. *Discussion.* We conclude that enhanced services should be treated as nonregulated services for accounting and jurisdictional separations purposes. Our accounting rules specify that activities never subject to regulation are to be classified as "nonregulated."[26] The Commission first defined "enhanced services" during the *Computer II* proceeding, and concluded that enhanced services are not common carrier services and should not be regulated under Title II of the Communications Act.[27] Exchange carrier enhanced services have never been treated as regulated activities for purposes of the accounting or jurisdictional separations rules. We see no reason to change that treatment now.

19. Significantly, as many commenters note, changes in our accounting treatment of enhanced services are entirely unnecessary to protect against improper cross-subsidy. Application of the joint cost rules already ensures that interstate ratepayers do not bear costs associated with enhanced

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merce Commission, Missouri Public Service Commission, Oklahoma Commerce Commission, and the Public Utilities Commission of Texas.

[24]California PUC Comments at 11-12.

[25]NYNEX Reply at 30-31.

[26]47 C.F.R. § 32.23(a).

[27]*Final Decision*, 77 FCC 2d at 428-32.

services. By contrast, treating enhanced service costs as regulated for accounting and jurisdictional separations purposes would require large scale modifications in the Commission's existing regulatory processes as well as in the carriers' internal accounting systems. For instance, jurisdictional separations would need to be amended in order to address enhanced service costs. Expanding the separations process to deal with all LEC-provided enhanced services would be a massive undertaking. The carriers would also likely incur substantial costs to revise their accounting systems and to prepare studies necessary to adopt separations methodologies applicable to enhanced services. The difficulty, complexity, and expense for regulators and the carriers would be exacerbated by the lack of historical data or previous studies regarding the jurisdictional usage of enhanced services.

20. Our decision not to subject enhanced service costs to jurisdictional separations does not represent, as SWRRG and the California PUC suggest, preemption of state regulation. Absent jurisdictional separations, states that choose to regulate rates for intrastate enhanced services are generally free to do so.[28] There is little, if any, state regulation of enhanced service rates at this time.[29] Therefore, undertaking

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[28]Classification of Inside Wiring Services for Accounting Purposes, *Memorandum Opinion and Order on Review*, 5 FCC Rcd 3521 (1990), *recon. dismissed*, FCC 91-387 (adopted November 21, 1991).

[29]On May 16, 1991, the Federal-State Joint Conference on Open Network Architecture adopted a resolution that enhanced services should not be subject to tariffing or entry/exit regulation. NTIA notes that enhanced services "are not per se regulated by the Commission or, presently, by the states." NTIA Comments at 13. Contrary to the argument advanced by the California PUC, *see* California PUC Comments at 12, section 410(c) of the Communications Act does not require that we apply jurisdictional separations procedures to non-common carrier services, such as enhanced services *See* Detariffing the Installation and Maintenance of Inside Wiring, *(Third Report and*

the burden of formulating and operating jurisdictional separations rules for enhanced services is neither necessary nor warranted. A state choosing to regulate enhanced service rates should bear the effort and expense associated with such regulation.

b. Independent Audits

21. The *Notice* proposed to strengthen the standard to be used by independent auditors in preparing their reports on carriers' cost allocation manual implementation and results. The joint cost rules required the independent audit reports to meet the professional standards for an attest audit.[30] Specifically, we proposed to require carriers' independent auditors: (a) to provide the same level of assurance in their audits as that undertaken in a financial statement audit engagement, (b) to render an opinion on whether the carrier's cost allocation methodologies are in conformity with its cost allocation manual and whether the results fairly present the results of the company's operations, and (c) to evaluate and report upon the carriers' internal controls when auditors rely upon those controls in determining the extent of auditing procedures.[31]

22. *Comments.* Some commenters contend that the benefits do not justify the additional costs associated with changes to the independent audit requirement.[32] USTA, the American Institute of Certified Public Accountants

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Order), CC Docket No. 79-105, FCC 91-386 (adopted November 21, 1991).

[30]*See* note 11, *supra.*

[31]In late 1990, the Common Carrier Bureau's Accounting and Audits Division imposed similar standards on a one-time basis for purposes of the independent audit reports for 1990 operations. Responsible Accounting Office (RAO) Letter 12, DA 90-1491, revised October 19, 1990, released October 23, 1990.

[32]Contel Comments at 10; GTE Comments at 9.

(AICPA), and several LECs support the proposal but recommend modifications. AICPA and several LECs suggest changing the wording of the "presents fairly" requirement.[33] Some parties suggest that the Commission explicitly require compliance with the professional audit standards contained in the Generally Accepted Auditing Standards (GAAS), noting that the *Notice* mentions only two of the ten standards contained in GAAS. Finally, some parties object to the proposed requirement for a separate report on the adequacy of carriers' internal controls, claiming that the proposal is unnecessary because GAAS already requires an evaluation of internal controls as part of a financial statement audit, and a separate report would increase the expense of the audit.

23. *Discussion.* We here adopt our proposal to strengthen the independent audit requirement, with some minor modifications. We conclude that the independent auditors should provide the same level of assurance as that provided in a financial statement audit engagement.[34] USTA, supported by several LECs, proposes language that makes clear that the independent auditors are to evaluate the results of applying carriers' cost allocation manuals in light of the requirements of the manuals as well as our joint

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[33]AICPA Comments at 9; *see also* USTA Comments at 8; Ameritech Comments at 18; Bell Atlantic Comments at 18; U S West Comments 102-103; SNET Comments at 11.

[34]*Notice*, 6 FCC Rcd at 178. The AICPA and several LECs suggest amending the wording of the proposed rule. The AICPA suggests language that would effectively lessen the standard, but did not explain its rationale for proposing such language. AICPA Comments at 9; *see also* Ameritech Comments at 18. We decline to adopt AICPA's proposed language because it would reduce the effectiveness of the independent audit as a safeguard against cross-subsidization.

cost rules and other pertinent regulations.[35] We agree that we should state specifically the regulatory requirements to be considered by the independent auditors, and therefore incorporate the suggested language in section 69.904 of our rules.

24. We also require that independent auditors follow GAAS. The *Notice* referred to the professional standards governing independent auditors. Independent auditors must follow all of the ten standards of GAAS in preparing the required reports. At the same time, however, we specifically do not disclaim our authority, for purposes of regulatory compliance, to prescribe the manner in which the independent audit reports are prepared and presented. For that reason, as is currently the case with respect to the application of generally accepted accounting principles (GAAP),[36] we shall state explicitly in our rules that GAAS shall control only insofar as it is not inconsistent with the rules or directives of the Commission (or its staff on delegated authority). Finally, we agree with the AICPA and several of the LECs that adoption of GAAS by reference obviates the

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[35]USTA's proposed language precisely tracks the wording of the sample opinion letter appended to RAO Letter 12, which imposed one-time strengthened requirements for the 1990 independent audits. That language requires an independent audit "that provides a positive opinion on whether the applicable data shown in the carrier's annual report required by Section 43.21(f)(2) of this Chapter presents fairly, in all material respects, the information of the carrier required to be set forth therein in accordance with the carrier's cost allocation manual, the Commission's Joint Cost Orders issued in conjunction with CC Docket No. 86-111, and the Commission's rules and regulations thereto including Sections 32.23, 32.27, 64.901 and 64.903 in force as [of] the date of the auditor's report." USTA Comments at 9.

[36]47 C.F.R. §§ 32.12(a) and 32.16(a).

need for a duplicative report on the carriers' internal controls. Accordingly, we shall not require such a report.[37]

c. Uniformity in Cost Allocation Manuals

25. In the *Notice* we proposed to require the Common Carrier Bureau to study a means of achieving greater uniformity in the carriers' cost allocation manuals.

26. *Comments.* Several state and federal agencies and other commenters support that proposal.[38] ADAPSO argues that the Commission should mandate uniformity and not defer to the judgment of the Common Carrier Bureau.[39] The Alarm Industry and MCI both contend that we should specify detailed proposals and timetables for achievement of greater uniformity in carrier cost allocation manuals.[40]

27. The LECs support efforts to promote cost allocation manual uniformity, but generally oppose a requirement of absolute uniformity in cost allocation practices. They argue

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[37]For the past four years, the independent audit requirement has proven to be extremely useful in reviewing implementation of the carriers' cost allocation manuals and the results of cost allocations under the manuals. Our proposal to strengthen the financial audit standard for independent audits represents not a failure of our accounting safeguards, but rather an effort to fine-tune a measure that has been highly effective since its adoption. As explained elsewhere in this Order, the independent audit, while valuable, is only one of several measures that comprise our set of cost accounting safeguards. As to the Alarm Industry's request that we adopt procedures to discourage opinion shopping in selecting independent auditors, we see no reason to change our disposition of that matter in this proceeding. *See Joint Cost Order,* 2 FCC Rcd at 1331-1333. We can revisit the issue later if opinion shopping ever becomes a significant obstacle to the independent audit process.

[38]NTIA Comments at 13; Hawaii PUC Comments at 13; Illinois CC Comments at 7; Michigan PSC Comments at 8; SWRRG Comments at 10; CBEMA Comments at 6; Ad Hoc Users Comments at 28.

[39]ADAPSO Comments at 35.

[40]Alarm Industry Comments at 10; MCI Comments at 61.

that complete cost allocation manual uniformity among carriers is inconsistent with the principle of cost causation set forth in the *Joint Cost Order,*[41] and that requiring a uniform set of cost pools would force a carrier to create cost pools that it would not utilize, contrary to Commission orders requiring carriers to remove hypothetical cost pools from their cost allocation manuals.[42] These parties state that complete uniformity in most accounts, cost pools, and apportionment and time reporting methods is not possible due to differences among the LECs' operations, organizations, records, systems, and nonregulated activities.[43] They argue that cost allocation manual revisions to implement a uniformity requirement would be administratively inconvenient and costly, disrupt quarterly cost allocation manual filings, interrupt year-to-year tracking of actual business specific expenditures, and potentially create an adverse effect upon annual access tariff filings through changing allocation

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[41]USTA Comments at 10; BellSouth Comments at 21-22; NYNEX Comments at 38; Pacific Comments at 42; SWBT Comments at 34; U S West Comments at 103-04; Centel Comments at 5-6; Cincinnati Bell Comments at 4.

[42]USTA Comments at 11; Bell Atlantic Comments at 20; BellSouth Comments at 22; SWBT Comments at 33-34; U S West Comments at 104. Under section 64.901 of the Commission's Rules, 47 C.F.R. § 64.901, costs which cannot be directly assigned to either regulated or nonregulated activities are considered common costs. Common costs are grouped into homogeneous costs categories, or cost pools, to facilitate the proper allocation of costs between a carriers' regulated and nonregulated activities in accordance with a hierarchy of preferred cost allocation techniques. *See also Joint Cost Order,* 2 FCC Rcd at 1343, Appendix B.

[43]USTA Comments at 10; Ameritech Comments at 19; Bell Atlantic Comments at 20; BellSouth Comments at 21-22; NYNEX Comments at 37-38; Pacific Comments at 42; SWBT Comments at 32-33; U S West Comments at 103-04; Centel Comments at 6; Cincinnati Bell Comments at 3-4; GTE Comments at 13-14; Rochester Comments at 9; SNET Comments at 12-13.

methods.[44] Finally, they claim that a requirement of uniformity could delay the introduction of new enhanced services and carrier reaction to competitive opportunities due to the need to develop uniform industry procedures.[45]

28. *Discussion.* Increased uniformity in LEC cost allocation practices would facilitate our review of those practices and help ensure that they are reasonable and accurate. Although staff efforts to date have resulted in more uniformity than in the originally filed cost allocation manuals, we conclude that even greater uniformity in cost allocation practices is highly desirable to the extent feasible. The benchmarking process facilitated by ARMIS should prove still more effective if greater uniformity in carriers' cost allocation processes can be accomplished. Moreover, this goal should be met expeditiously.

29. We therefore direct the Common Carrier Bureau to analyze the cost allocation practices of subject carriers to determine ways to obtain greater uniformity in carriers' cost allocation procedures and practices. The Bureau is further directed to prepare a request for comments addressing proposed uniformity requirements and to promulgate uniformity requirements upon delegated authority. This effort is a matter of significant priority. We direct the Bureau to proceed on an expedited basis in implementing cost allocation requirements that produce greater uniformity among carrier practices.[46]

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[44]Centel Comments at 7; Cincinnati Bell Comments at 4-6; Rochester Comments at 8-9; SWBT Comments at 33-34;

[45]USTA Comments at 11; Ameritech Comments at 20; BellSouth Comments at 22; U S West Comments at 104; SNET Comments at 13.

[46]The carriers have asserted, and no one has disputed, that absolute uniformity would be nearly impossible to achieve given the differences in the business operations, systems, and records of the subject carriers. In light of the undisputed disparities in carrier operations, it would not be

d. Quantification of the Effects of Cost Allocation Manual Changes

30. Our fourth accounting proposal involves quantification of the effects of revisions to the cost allocation manuals. The *Notice* indicated that such estimates could assist Commission staff as well as interested parties in focusing attention on the most significant manual revisions.

31. *Comments.* Federal and state agencies support this proposal,[47] although the DC PSC expresses general reservations regarding the cost allocation process.[48] The Ad Hoc Users also support the proposal.[49]

32. Some LECs claim that quantification is unnecessary, irrelevant, burdensome, and that its cost would outweigh any benefits.[50] Other LECs argue that quantification would be difficult because carriers do not have systems in place to quantify changes at the cost pool level.[51] Several carriers contend that the financial impact of new ventures (or of cost allocation manual changes generally) may not be known at the time that these changes are filed.[52] NYNEX claims that the filing of financial impact estimates would reveal proprietary information concerning new nonregulated service offer-

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prudent to impose an immediate requirement of absolute uniformity and we do not do so.

[47]NTIA Comments at 13; DC PSC Comments at 25-26; Hawaii PUC Comments at 13; Illinois CC Comments at 6; Michigan PSC Comments at 8-9; SWRRG at 10.

[48]DC PSC Comments at 25-26.

[49]Ad Hoc Users Comments at 29, Appendix 1 at p. 5.

[50]Centel Comments at 8; SNET Comments at 14; U S West Comments at 105.

[51]USTA Comments at 12; BellSouth Comments at 23.

[52]NYNEX Comments at 40; Pacific Comments at 43-44; U S West Comments at 104-05; Cincinnati Bell Comments at 6-7.

ings.[53] A few LECs suggest that the quantification requirement proposed in the *Notice* be replaced with a requirement that carriers state whether the effect of a cost allocation manual revision exceeds a specified threshold amount.[54] The majority of LECs argue that carriers should be allowed to provide a range of the estimated dollar effects of any cost allocation manual changes.[55]

33. *Discussion.* The purpose of quantifying the effects of revisions to cost allocation manuals is to help interested parties and Commission staff to identify changes in cost allocations that potentially could have a significant impact on regulated and nonregulated activities. We conclude that requiring quantification of cost allocation manual changes to the nearest $100,000 strikes a reasonable balance between relieving the carriers of the burden of precise quantification and preserving the ultimate usefulness of quantification of cost allocation manual revisions. Quantification would not need to be provided for a change with a financial impact of less than $100,000.

34. The reporting ranges proposed by the LECs are so broad that the information provided would be meaningless. USTA, supported by numerous LECs, propose the following ranges: for balance sheet effect, $0-10 million, $10-50 million, and greater than $50 million; for income statement effect, $0-1 million, $1-10 million, $10-50 million, and

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[53]NYNEX Comments at 40.

[54]Bell Atlantic Comments at 21; NYNEX Comments at 41; SWBT Comments at 35; Cincinnati Bell Comments at 7; Rochester Comments at 11.

[55]USTA Comments at 12-13; Ameritech Comments at 20-21; BellSouth Comments at 24; Pacific Comments at 44; SWBT Comments at 35; Cincinnati Bell Comments at 6-7; GTE Comments at 14-15; Rochester Comments at 11; SNET Comments at 14.

greater than $50 million.[56] We do not believe that the relative significance of cost allocation manual changes could be ascertained if such large ranges were used.

35. Some commenters have requested that carriers be allowed to quantify changes at the account level rather than at the more detailed cost pool level.[57] We conclude that the level of quantification should not be the same for all types of manual changes. There are three types of manual changes that are susceptible to quantification: (1) changes in time reporting procedures; (2) changes related to affiliate transactions; and (3) changes in the cost apportionment tables. Cost allocation manual changes related to time reporting and affiliate transactions generally occur at or above the account level. In addition, such quantification at the more detailed cost pool level would be very difficult. We therefore require, at a minimum, that carriers quantify changes in time reporting and affiliate transaction at the account level.

36. Changes in the cost apportionment tables, on the other hand, generally are made at the cost pool level and carriers reasonably can be required to quantify the effects of those changes at that level. Moreover, if quantification were to take place at the account level, simultaneous changes in several cost pools within a given account could offset one another in the quantification process and thereby mask significant changes in the results at the cost pool level. Thus, the reporting of changes only at the account level might not reveal significant changes at the cost pool level. Such a result would frustrate the purpose of adopting a requirement that carriers quantify the effects of cost allocation manual

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[56] *Ex Parte* Letter from Martin McCue, Vice President and General Counsel, United States Telephone Association, to Donna R. Searcy, Secretary, FCC, June 26, 1991.

[57] *E.g.*, Cincinnati Bell Comments at 6-7.

changes. We therefore require that changes to cost apportionment tables be quantified at the cost pool level.

e. Materiality Threshold of Errors and Omissions

37. We also proposed to direct the Common Carrier Bureau to study whether to establish a reasonable threshold for determining the materiality of errors and omissions discovered in the independent audits of carrier filings.

38. *Comments.* With the exception of the LECs and the AICPA, all parties commenting upon this issue support the proposal. A few of those commenters ask that the Commission mandate a materiality threshold rather than deferring to the judgment of the Bureau or that the Commission provide detailed proposals and timetables for establishment of specific standards for the materiality of errors and omissions.[58]

39. The AICPA and the LECs argue that a materiality threshold specified by the Commission may be inconsistent with GAAS.[59] Three carriers contend that if the Commission were to specify a materiality threshold for the planning process of the independent audits, a report based upon such procedures could not be made available for general distribution.[60] BellSouth argues that the cost of the independent audit could escalate dramatically if the Commission were to specify a materiality threshold lower than that already used

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[58]ADAPSO Comments at 35; Alarm Industry Comments at 10; MCI Comments at 61.

[59]AICPA Comments at 10; USTA Comments at 13; Ameritech Comments at 21; BellSouth Comments at 24-26; NYNEX Comments at 41-42; Pacific Comments at 45-46; SWBT Comments at 36-37; U S West at 105-106; GTE Comments at 11-13; SNET Comments at 15.

[60]BellSouth Comments at 25-26; SWBT Comments at 36-37; U S West Comments at 106.

by independent auditors.[61] Finally, the AICPA and several of the LECs argue that the Commission should refrain from prescribing a materiality threshold for planning the audit and, instead, limit our action to setting a materiality threshold for purposes of reporting audit results and correcting errors or omissions that exceed the threshold.[62]

40. *Discussion.* It is important that the independent audits serve their intended purpose and that the independent auditors use an appropriate materiality threshold in planning their audits. Materiality thresholds can aid audit planning. Moreover, as the Michigan PSC suggests in its comments, setting a materiality threshold could facilitate consistent review of carriers' cost allocations.[63] In addition, the independent audits of cost allocation manual implementation and results differ from typical audits in that they serve a regulatory purpose.[64] For that reason, it is essential that the materiality thresholds used by the independent auditors in planning their audits are appropriate in order to ensure accurate results of the cost allocations required under our rules.

41. We therefore direct the Common Carrier Bureau to monitor the materiality thresholds used by the various independent auditors to ensure that each threshold is suitable for the operations of the carrier(s) for which it is employed. In addition, we hereby authorize the Bureau to take such action regarding the materiality thresholds as it deems necessary to ensure consistent and appropriate independent audits. This authorization includes, but is not lim-

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[61]BellSouth Comments at 26-27.

[62]AICPA Comments at 10; USTA Comments at 13-14; Ameritech Comments at 21; NYNEX Comments at 42-43; Pacific Comments at 46.

[63]Michigan PSC Comments at 9.

[64]McGraw-Hill Reply at 10-11.

ited to, setting a uniform materiality threshold or multiple materiality thresholds for different types or sizes of carrier operations. We authorize the Bureau to prescribe materiality thresholds, as necessary, for purposes of planning the independent audits as well as for reporting and correcting errors and omissions to carriers' reports to the Commission. Such authority is essential because it is possible that many errors and omissions exceeding a prescribed materiality threshold would not be discovered unless a suitable threshold were also used in planning the audit. We disagree with commenting parties who argue that setting a materiality threshold would interfere impermissibly with the preparation of the independent audit reports.[65]

2. *Use of Strengthened Accounting Safeguards to Protect Against Cross-Subsidization.*

a. Comments

42. A number of commenters claim that there is no evidence that cost allocation rules can prevent cross-subsidization.[66] These commenters contend that the Commission cannot rely on any form of cost accounting safeguards because those safeguards rely on allocations, rather than isolation of costs through structural separation,[67] and because cost allocations inherently entail an unacceptable

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[65]Parties present their arguments on this issue in relatively conclusory fashion, without reference to specific professional auditing standards to support their position and without explanation of how a prescribed materiality threshold would interfere with preparation of the required audit report.

[66]ANPA Comments at 13; CompuServe Comments at 18-19; CBEMA Comments 5-7; IDCMA Comments at 9-15; Iowa Network Services Comments at 15; MessagePhone Comments at 10; NAB Comments at 4; WUTC Comments at 8-9; Stroh Comments at 1-2.

[67]DC PSC Comments at 17; McGraw Reply at 9-10; Florida Comments at 6; CBEMA Comments at 5; ADAPSO Comments at 9-12;

potential for intentional or inadvertent misallocation of costs.[68] Others argue that accounting safeguards give the BOCs too much discretion in devising allocation formulas,[69] service definitions, and service descriptions,[70] and that the BOCs control the underlying information used to allocate these costs, such as time reporting by repair technicians.[71] MCI also asserts that our cost allocation rules do not prevent cross-subsidization at the intrastate level.[72]

43. Some commenters contend that the Commission does not have the resources available to implement or enforce the cost allocation rules.[73] They claim that ARMIS is inadequate to detect cross-subsidies because the benchmarking process does not reveal subtle cross-subsidies or misallocations common to all of the BOCs.[74] They also argue that the data provided by individual carriers are not comparable, and the form and manner in which the data are collected keeps changing. Several parties claim that the enforcement actions cited in the *Notice* show not the ability of the Commission to enforce the cost accounting safeguards, but rather the ability of the BOCs to succeed in

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MCI Comments at 49-52; ANPA Comments at 16; CompuServe Comments at 19-20; IDCMA Comments at 10-11.

[68]SWRRG Comments at 9; WUTC Comments at 9-10.

[69]MCI Comments at 52-56.

[70]Ad Hoc Comments at 24-25; MCI Reply at 37.

[71]MCI Comments at 55-56.

[72]MCI Comments at 42-45.

[73]McGraw Comments at 11; Alarm Industry Comments at 6-8; IDCMA Comments at 11-12; CompuServe Comments at 26-27; Messagephone Comments at 10; MCI Comments at 61-63; DC PSC Comments at 19-20; WUTC Comments at 9 (true for state regulators as well).

[74]MCI Reply at 38-39.

cross-subsidization.[75] Some parties express concern that cross-subsidies and other pricing improprieties could go undetected indefinitely or could be discovered only after damage to the competitive marketplace has occurred.[76] Ad Hoc claims that the Commission's affiliate transaction rules do not permit the Commission effectively to detect abuses because actual affiliate transactions are not separately reported.[77] Parties who claim that cost allocation rules cannot protect against cross-subsidy also generally disagree with the *Notice's* observation that adoption of incentive regulation for the LECs reduces BOC incentives to cross-subsidize.

44. Many parties, including DOJ and NTIA, strongly support use of accounting safeguards to protect against cross-subsidization.[78] These parties state that the BOCs have provided nonregulated services for many years and have not been able to establish market dominance in any of the unregulated markets in which they compete, or harm consumers by raising regulated rates.[79] In addition, these parties note that the Ninth Circuit did not have the benefit of the record established in the *Joint Cost Proceeding*, and

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[75]MCI Reply at 32-35; IDCMA Reply at 3-4.

[76]ANPA Comments at 19; CBEMA Comments at 5-6; IDCMA Comments at 13-14; Iowa Network Services Comments at 13-14; MCI Comments at 59-60; WUTC Comments at 9.

[77]Ad Hoc Comments at 23. Ad Hoc also contends that the affiliate transaction rules should encompass services. *Id.* at 23-24.

[78]NTIA Comments at 5, 8-10; DOJ Comments at 4-7; CSE Foundation Comments at 7-8; CBT Comments at 2-3; NYNEX Comments at 21-32; SNET Comments at 3-5; Pacific Comments at 32; Bell Atlantic Reply at 4; USTA Comments at 2-4; U S West Comments at 99; Vermont State DPSC Comments at 1; Illinois CC at 6-7.

[79]CSE Foundation Comments at 7. According to Bell Atlantic and SWBT, the BOCs have only a 10% market share in the CPE market, indicating that BOC entry into competitive markets has not discouraged competition. Bell Atlantic Reply at 4-7; SWBT Reply at 37-38.

thus there was little evidence showing that effective cost accounting rules could in fact be developed and implemented. NTIA, DOJ, and others, including the BOCs, state that since adoption of the *Computer III* decision, the Commission has devised and implemented a comprehensive and viable set of cost accounting safeguards to protect against cross-subsidization, including cost allocation rules, cost allocation manual filings, independent audit requirements, ARMIS submissions, and on-site field audits.[80]

45. Parties supporting use of cost accounting rules also contend that the manner in which the Commission devised the cost allocation and affiliate transaction rules actually benefits regulated ratepayers.[81] Moreover, these parties argue that nearly four years of Commission and industry experience with these rules demonstrate that cost accounting safeguards can and do control the ability of the BOCs to cross-subsidize such that the benefits of replacing structural separation with nonstructural safeguards outweighs the potential costs.[82] Furthermore, these commenters state that LEC price cap regulation substantially reduces BOC incentives to cross-subsidize because the BOCs cannot automatically pass on to ratepayers increases in costs.[83]

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[80]Pacific Comments at 32-33; U S West Comments at 99-100; Bell Atlantic Reply at 8.

[81]CSE Foundation Comments at 8; NYNEX Comments at 25-26; U S West Comments at 100-101; Rochester Comments at 7, n. 16; Pacific Reply at 16; SWBT Comments at 28.

[82]NTIA Comments at 10; NYNEX Comments at 21-23; Pacific Comments at 32; Bell Atlantic Reply at 4.

[83]CSE Foundation Comments at 8-9; NYNEX Comments at 32; Rochester Comments at 7; SNET Comments at 6-7; SWBT Comments at 21-22; Pacific Reply at 24-25.

b. Discussion

46. We conclude that our comprehensive system of cost accounting safeguards has worked well and, as strengthened above, effectively protects ratepayers against cross-subsidization by the BOCs. This system consists of five principal parts: (1) the establishment of effective accounting rules and cost allocation standards; (2) the requirement for telecommunications carriers to file cost allocation manuals reflecting the established rules and standards; (3) the requirement for audits by independent auditors of carrier cost allocations, requiring a positive opinion on whether carriers' allocations comply with their cost allocation manuals; (4) the establishment of detailed reporting requirements and the development of an automated system to store and analyze the data; and (5) the performance of on-site audits by FCC staff.

47. The Uniform System of Accounts (USOA) prescribed by the Commission establishes the regulated accounts that carriers must use. After nearly fifty years without significant modification, the Commission substantially revised the USOA, effective January 1, 1988, to reflect significant changes in the industry and modern accounting practices.[84] In the *Joint Cost Proceeding*, the Commission adopted joint cost rules to ensure that carriers are not permitted to assign the costs of nonregulated activities to the provision of regulated services. Under the Commission's cost allocation rules, costs are directly assigned to regulated or nonregulated activities whenever possible. In the event that costs cannot be directly assigned, costs are assigned, if possible, to regulated or nonregulated activities based on

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[84]Revision of the Uniform System of Accounts and Financial Reporting Requirements for Class A and Class B Telephone Companies, 51 Fed. Reg. 43,498 (December 2, 1986).

cost causation principles. Remaining costs are then allocated according to general allocation factors.

48. Moreover, these specific standards and rules are geared to protecting ratepayer interests. The Commission could have decided to adopt an incremental costing approach for nonregulated activities, which is likely to have encouraged faster and more extensive development and deployment of enhanced services by telecommunications common carriers. Instead, the Commission employed a fully distributed cost (FDC) allocation methodology. Under this methodology, nonregulated services must contribute towards the general overhead costs of the regulated operations, which would otherwise be borne entirely by the ratepayers of regulated services. Thus, an FDC approach assures that ratepayers will receive additional protection and benefit from the efficiencies gained through joint use of the network. The Commission also adopted affiliate transaction rules that prevent the BOCs from charging ratepayers inflated prices for goods and services obtained from nonregulated affiliates, or from providing these affiliates with goods and services at unduly low prices.[85] Additionally, the requirement that enhanced services costs be excluded from

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[85]47 C.F.R. § 32.27. Similarly, the affiliate transaction rules are geared to protecting ratepayers. According to those rules, asset transfers from regulated accounts are recorded by the BOCs at net book cost or fair market value, whichever is higher, while assets transferred from a nonregulated affiliate to a regulated carrier are recorded at the lower of net book cost or fair market value. These rules also cover the transfer of services to and from unregulated affiliates and regulated carriers in a manner that properly allocates costs to the appropriate activity. For services that are provided to or received from affiliates, the rules require that the affiliate pay the tariff rate or, if there is no tariff rate, the prevailing price (determined by transactions with nonaffiliates), or fully distributed cost. By structuring our affiliate transaction rules this way, the nonregulated activity bears not just its incremental costs for asset and service transfers but general overhead costs as well, which would otherwise be solely borne by regulated ratepayers.

separations will help assure that such costs are excluded from the interstate ratemaking process.[86]

49. As the second part of our system, the Commission has reviewed and approved BOC cost allocation manuals showing the cost allocation factors used to allocate joint costs and the manner in which the BOCs will implement cost allocations. The manuals provide detail on the nature of nonregulated activities and the cost accounts they affect, as well as cost allocation formulas and procedures. All the original cost allocation manuals were subject to public comment and Commission review. Before their original approval, the Commission required extensive revisions to the BOCs' cost allocation manuals.[87] Under the strengthened cost accounting safeguards adopted today, the BOCs will be required to quantify the effects of cost allocation manual changes in $100,000 increments at the cost pool level for cost apportionment changes and at the account level for changes in time reporting and affiliate transactions. This level of detail will improve the ability of staff and the public to evaluate proposed cost allocation manual changes. Additionally, as indicated, the Common Carrier Bureau is undertaking an examination of ways to achieve even greater uniformity in cost allocation manuals than currently exists, which could further enhance comparisons of BOC manuals.

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[86]By excluding enhanced services from separations, the Commission can directly ensure that interstate basic service ratepayers do not bear the costs of unregulated services. Our cost allocation safeguards also provide sufficient information for the states to protect against cross-subsidies at the intrastate level. The operation of the joint cost and separations rules results in a BOC intrastate assignment of basic services costs. To protect against cross-subsidy of enhanced services by intrastate ratepayers, a state need only use its normal regulatory mechanisms to ensure that intrastate rates are not too high in light of that assignment.

[87]*See* NYNEX Comments at 27; SWBT Comments at 29-30; NYNEX Reply at 15.

50. We have also required that the BOCs submit to annual audits conducted by independent auditors. The independent audit requirement has proven to be a very useful and cost effective tool in reviewing implementation of the carriers' cost allocation manuals and the results of cost allocations under the manuals. The requirement also assists Commission staff in evaluating carriers' compliance with the Commission's rules, as well as the effectiveness of the rules themselves. As strengthened by our action in this Order, independent auditors are required to provide the same level of assurance in their audits as that undertaken in a financial statement audit engagement. Under this level of assurance, the auditor will provide an opinion on the carrier's cost allocations in light of the requirements of the cost allocation manual approved by the Commission as well as of our joint cost rules and other pertinent regulations. Commission auditors continually review the audits submitted by the independent auditors.

51. The Commission also has imposed detailed reporting requirements for the BOCs' cost allocations and has developed and implemented ARMIS, an automated system to store and analyze the reported data. The ARMIS system contains detailed cost and revenue information that allows the Commission to make benchmark comparisons among the carriers and across time periods to identify discrepancies warranting Commission attention. In the *ARMIS Order*,[88] the Commission required carriers to file new computerized reports aimed at detecting improper cross-shifting. These reports are available to the states and to the public. The quarterly report contains certain financial data reflecting the results of the accounting and cost allocation requirements prescribed in Part 32 and Part 64 of the Commission's

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[88] *See* note 12, *supra*.

Rules.[89] Also, carriers are required to file an annual USOA Report displaying the results of their total activities for every account in the USOA, and an annual Joint Cost Report showing the allocation to regulated and nonregulated activities for all accounts involved in the ratemaking process. Over time, the Commission has refined the ARMIS reporting requirements in order to make benchmark comparisons more easily and readily available.

52. Commission staff also conducts targeted on-site audits. These audits determine whether specific carrier practices and procedures are in compliance with the joint cost rules and whether such practices and procedures are sufficient to prevent cross-subsidization. The commission examines, among other things, carrier procedures and practices that may be found to be potentially vulnerable to cross-subsidization. In preparation for on-site audits, Commission staff scrutinizes the independent audit reports, the detailed ARMIS submissions, complaints against the carriers, cost allocation manual filings, and internal analytical studies. These efforts permit the Commission to target on-site audits effectively on those carriers and those issues that most warrant Commission attention. Commission auditors, among other things, interview witnesses, study thousands of pages of workpapers, and review the carriers' own internal control systems designed to prevent cross-subsidy.

53. We are not persuaded by commenters who claim that these requirements and procedures will be inadequate to detect improper cross-subsidization. While allocation factors and the detailed manner of implementation of allocations are chosen by the BOCs, we have established

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[89]Part 32 contains the USOA, which lists the more than 250 accounts used by the carriers to record the costs and revenues of their regulated and nonregulated activities. Part 64 contains the rules adopted in the *Joint Cost Order* that separate regulated costs from the costs of nonregulated activities.

specific guidelines and reporting mechanisms for the BOCs to follow and, as has been done in the past, we will not hesitate to require changes in cost allocations when necessary. We conclude that our comprehensive system of accounting safeguards provide a reasonable and sufficient method of assuring that the cost allocation factors chosen by the BOCs and the manner of implementing the cost allocations set forth in the cost allocation manuals will not result in cross-subsidy. Similarly, MCI's claim that the BOCs routinely overproject regulated costs is completely unsupported.[90] Accordingly, we reject arguments of commenters that our cost allocation requirements are so vague as to permit carriers to engage in cross-subsidization.[91]

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[90]Moreover, under our joint cost rules, the BOCs are constrained from overallocating joint costs to the regulated side. If actual nonregulated usage does exceed projected peak usage, a reallocation of investment is required to the nonregulated side. The reallocation compensates the regulated operation for the time value of the costs it bore for the nonregulated operation. It also blunts any incentive for the BOCs to underestimate its future nonregulated demand with the goal of overallocating investment to the regulated operations.

[91]Nor are our rules defective because they fail to charge nonregulated operations for training when, for example, regulated service employees go to work for the nonregulated service operations. *See* MCI Comments at 10. Even under a structural separation requirement, a BOC employee could be trained by the regulated company and then subsequently transferred to the BOCs' nonregulated affiliate. In addition, the joint cost rules already address the question of "inter-temporal cross-subsidies" raised by Ad Hoc. *See* Ad Hoc Comments, Attachment at 12. In the *Joint Cost Proceeding,* we did not adopt a costing methodology that would have allocated the costs of regulated services (central office equipment and outside plant investment) between regulated and nonregulated services based on actual relative regulated and nonregulated use, but rather on the basis of intended relative use. The Commission adopted a projected use methodology to ensure that ratepayers do not bear the risks and costs of nonregulated business failures. For instance, if a cost were incurred largely to provide for future nonregulated services, and these services failed to grow as expected, we did not want regulated

54. Based on nearly four years experience with cost accounting safeguards, we are convinced that we will be able to continue to enforce these safeguards. Underlying information, including the time reporting of employees, is subject to audit both by independent auditors and Commission staff. Furthermore, ARMIS contains detailed reporting of the cost allocations that can be used to evaluate an individual BOC's actual allocations of costs as well as to make benchmark comparisons between the BOCs. MCI's claims that these reports do not reveal subtle cross-subsidies is unsupported and unexplained. The Commission has refined the ARMIS requirements to facilitate meaningful benchmark comparisons. The Commission also has adequate resources to monitor the BOCs' activities.[92] Contrary to the view of some commenters, our enforcement action against the NYNEX telephone companies for apparently improper affiliate transactions between New York Telephone and New England Telephone, and NYNEX's nonregulated affiliate, the Material Enterprises Company (MECO) supports the efficacy of our affiliate transaction rules. [93]

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ratepayers to pay for the nonregulated share of the costs. *Joint Cost Order,* 2 FCC Rcd at 1320, paras. 169-172.

[92]We will also work with Congress to secure additional resources if they become necessary.

[93]Based on a Common Carrier Bureau audit, we tentatively concluded that MECO had overcharged its telephone company affiliates by a total of $118.5 million from 1984 through 1988. Accordingly, this Commission ordered New York Telephone and New England Telephone to show cause why they should not be required to remove $32.6 million in excessive capital costs from their rate base, and perform ratemaking adjustments to return $35.5 million in improper charges imposed on interstate ratepayers. This Commission also found the two telephone companies apparently liable for forfeitures totaling $1.419 million for violation of the Commission rules. *See* New York Telephone Co. and New England Telephone and Telegraph Co., Apparent Violations of the Commission's Rules and Policies Governing Transactions with Affiliates, *Order to Show Cause and Notice of Apparent Liability for*

55. We also conclude that the implementation of LEC price cap regulation as of January 1, 1991, is a significant regulatory development since the *BOC Separation Order* that reduces BOC incentives to cross-subsidize enhanced services with basic services.[94] Under rate-of-return regulation, a regulated carrier is entitled to charge basic service rates that reflect regulated costs plus a reasonable rate of return on investment. As a practical matter, misallocation of nonregulated costs to regulated operations under rate-of-return regulation increases a carrier's regulated costs and therefore permits higher regulated rates to recover the improperly allocated nonregulated costs. By contrast, because price cap regulation severs the direct link between regulated costs and prices, a carrier is not able automatically to recoup misallocated nonregulated costs by raising basic services rates, thus reducing the incentive for the BOCs to shift nonregulated costs to regulated services.[95]

Forfeitures, 5 FCC Rcd 866, 870-871, paras. 31, 33 (1990). New York Telephone and New England telephone denied any allegations of wrongdoing. A consent decree was entered into on October 3, 1990, in which NYNEX agreed to reduce its interstate capital account balances by $32.6 million, to reduce interstate revenue requirements by $35.5 million, and to make contributions to the United States Treasury in the amount of $1.419 million. *See* New York Telephone Co. and New England Telephone and Telegraph Co., *Apparent Violations of the Commission's Rules and Policies Governing Transactions with Affiliates*, 5 FCC Rcd 5892 (1990), *recon. denied*, 6 FCC Rcd 3303 (1991), *appeals pending sub. nom.*, New York v. FCC, No. 91-1362 (D.C. Cir. filed August 5, 1991). Having obtained for interstate ratepayers and the Treasury all of the relief sought in the *Order to Show Cause*, we agreed to terminate the proceeding without a finding of wrongdoing on the part of NYNEX.

[94]*See* CSE Foundation Comments at 9; NYNEX Comments at 32; Rochester Comments at 7; SNET Comments at 6-7; SWBT Comments at 21; Pacific Reply at 24-25.

[95]*See* NYNEX Comments at 32; Rochester Comments at 7; SNET Comments at 6-7; SWBT Comments at 21; Pacific Reply at 24-25.

56. The Court in *California v. FCC* vacated *Computer III* in its entirety because the Court concluded that the Commission had not presented a sufficient justification for reliance on cost accounting safeguards so soon after its decision in the *BOC Separation Order* to continue structural separation for BOC enhanced services operations. Based on our experience of nearly four years, and based on the record developed on remand, we conclude that our cost accounting safeguards constitute a realistic and reliable alternative to structural separation to protect against cross-subsidy. We find as well that the adoption and implementation of incentive regulation for the BOCs serves as an effective complement to these cost accounting safeguards by reducing BOC incentives to cross-subsidize their enhanced services. We further conclude that the effectiveness of those nonstructural safeguards renders any costs of eliminating structural separation marginal.

B. *Safeguards Against Discrimination*

57. The *Notice* proposed the following nonstructural safeguards to protect independent ESPs from possible BOC discrimination in the provision of access to underlying basic

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Several parties claim that the BOC's have an incentive, pending the price cap review of the productivity offset in 1994, to load up their regulated operations with additional costs in order to avoid an increase in their productivity offset. *See, e.g.*, MCI Comments at 24; DC PSC Comments at 23-24. Furthermore, as recognized in the *Notice*, there may be some incentive remaining under price cap regulation for LECs whose earnings are approaching the sharing mark to try to shift costs to the regulated side of its operations. *See* Ad Hoc Comments at 22. We do not find here that LEC price cap regulation eliminates all possible incentive to shift costs. We find, rather, that these incentives under price caps are much less significant than under rate-of-return regulation, for the BOCs are no longer automatically entitled to increase rates to recoup cost increases. LEC price cap regulation serves as an effective complement to cost accounting, reporting, auditing, and enforcement safeguards.

services: (1) ONA, as adopted by the Commission in December 1990; (2) the *Computer III* nondiscrimination reporting requirements; (3) *Computer III* network information disclosure rules; and (4) CPNI disclosure rules. The *Notice* proposed to rely on ONA, which the Commission readopted at the time of the *Notice*. The *Notice* also proposed to adopt the *Computer III* nondiscrimination reporting requirements and network information disclosure rules, and requested comment on whether we should modify the CPNI rules. Finally, the Commission proposed, irrespective of its broader decisions regarding structural and nonstructural safeguards, to eliminate both the capitalization plan requirement and the prohibition against a regulated BOC and a BOC affiliate from performing software development for one another.

58. In this *Report and Order*, we conclude that a set of nonstructural safeguards will effectively protect against potential discrimination by the BOCs in provision of basic services to competing ESPs. Contrary to the requests of some commenters, fundamental changes in our ONA requirements are not necessary in order to rely on them for protection against discrimination. We readopt the *Computer III* nondiscrimination requirements as effective protections against discrimination in quality, and in installation and maintenance of basic services. We also readopt the *Computer III* network disclosure rules to assure that competing ESPs obtain critical network information in a timely fashion. We adopt modified CPNI requirements that require BOC enhanced services marketing personnel to obtain prior authorization before accessing the CPNI of customers with more than twenty lines. These safeguards, along with nonstructural safeguards against cross-subsidization, should effectively protect against anticompetitive conduct by the BOCs toward competing ESPs. We also eliminate the capitalization plan requirement and the prohibition against a

BOC and unregulated affiliates performing software development for one another.

1. *Open Network Architecture*

59. *Background.* The *Phase I Order* in *Computer III* adopted CEI requirements so that unaffiliated ESPs could obtain nondiscriminatory access to the underlying basic network services used by the BOCs in their provision of enhanced services. Under CEI, the BOCs were required to provide their ESP competitors with "equal access" interconnections to basic network services at the same tariffed rates that the BOCs themselves paid.[96] The Commission also required that the BOCs implement ONA, which extended CEI principles beyond the underlying services used to provide their own enhanced services to the BOCs' overall basic networks and which was designed to increase opportunities for ESPs to use the regulated networks of the BOCs in a nondiscriminatory manner. Under ONA, the BOCs were required to develop plans describing how they would provide unbundled basic service "building blocks," so that competing ESPs could use network services in a flexible and economical manner. Specifically, we required the BOCs to make available basic services, features, and functions requested by ESPs, based on the expected market demand for such elements, their utility as perceived by enhanced service competitors, and the technical and costing feasibility of such unbundling.[97]

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[96]Basic services used in the provision of BOC enhanced services had to "be available to others on an unbundled basis, with technical specifications, functional capabilities, and other quality and operational characteristics, such as installation and maintenance times, equal to those provided to the carrier's enhanced services." *Phase I Order,* at 1036-1037, paras. 147, 150, n. 210.

[97]*Phase I Order*, 104 FCC 2d at 1065-1066, pares. 214, 217.

60. Following the Ninth Circuit's vacation and remand of *Computer III*, we proposed to reinstate ONA, which had not been challenged before the Ninth Circuit.[98] At the time we adopted the *Notice* in this proceeding, we also adopted an Order requiring the BOCs to implement ONA.[99]

61. *Comments.* A few parties argue that ONA will not be an effective safeguard against BOC access discrimination.[100] These parties argue that competing ESPs will never achieve access to the network comparable to that of the BOCs' enhanced services because ONA does not require the BOCs to allow independent ESPs to collocate their equipment at BOC central offices or require the BOCs to unbundle transport and switching.[101] Also, some parties assert that ONA, is just a repackaging of limited network services that were in existence and being offered prior to the development of ONA, and that the BOCs are reluctant to unbundle network offerings any further.[102] MCI claims that the BOCs' ONA plans do not contain proposals to deploy any new or improved unbundled types of ONA services.

62. *Discussion.* We conclude that ONA constitutes an effective safeguard, helping to ensure that independent ESPs obtain nondiscriminatory access to BOC basic services. The *California* Court did not criticize ONA, but stated that the record supported the Commission's findings that ONA "will be effective in reducing the risk of BOC

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[98]Computer III Remand Proceedings, CC Docket No. 90-368, *Notice of Proposed Rulemaking*, 5 FCC Rcd 5242 (1990).

[99]Computer III Remand Proceedings, CC Docket No. 90-368, *Report and Order*, 5 FCC Rod 7719 (1990).

[100]MessagePhone Comments at 11; ANPA Comments at 25; MCI Comments at 77; Ad Hoc Comments at 25.

[101]Ad Hoc Comments at 25-26; ANPA Comments at 25.

[102]ANPA Comments at 25; MCI Comments at 71-72.

access discrimination[.]"[103] Our experience with ONA since that time serves to reaffirm this conclusion. ONA has been developed in a meticulous fashion over the past five years. In particular, the BOCs were required to file detailed ONA plans in 1988, specifying the basic services they would provide to competing ESPs and the time of deployment, as well as the methods employed to comply with our other nondiscrimination safeguards. These ONA plans were subject to intense scrutiny by both the public and the Commission. In December 1988, the Commission released an order that approved the BOC ONA plans in substantial part but identified a number of areas that needed revision before ONA could be effectively implemented. In May, 1989, the BOCs filed amended ONA plans, which were again subject to public comment and careful review. In May 1990, we approved the amended plans, and authorized implementation of ONA. To ensure the continued evolution of ONA, the Commission required further amendments to the ONA plans, which were filed in April 1991, and are addressed in a companion order. On November 1, 1991, the BOCs filed federal tariffs for their initial ONA services.

63. We conclude that, given current network architecture and technical capabilities, the BOCs are generally meeting the basic service needs of the enhanced services industry. Since the filing of the original ONA plans, the BOCs have filed tariffs for initial ONA services. NYNEX alone has filed tariffs for twenty-one ONA services in response to requests by independent ESPs.[104] The BOCs' ONA plans describe in considerable detail their deployment plans for new ONA services, and the BOCs are continually

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[103]*California*, 905 F.2d at 1238.

[104]According to NYNEX, only two of these services are utilized in conjunction with NYNEX's enhanced service offerings. NYNEX Reply at 44-45.

introducing new ONA services that will be offered to ESPs.[105]

64. We are not persuaded by the conclusory arguments of some commenters that we need make fundamental changes in ONA in order to rely on it as a check against discrimination. Mandatory physical collocation of ESP equipment is not necessary to ensure comparable access. The *Phase I Order* sets forth nine parameters designed to ensure comparable technical access,[106] and the Commission has approved BOC parity pricing as satisfactorily providing comparable pricing.[107] In the *BOC ONA Order*, the Comission declined to require a radical reconfiguration or fundamental unbundling of the BOC networks, stating that providing ONA based on a more disaggregated, and at that

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[105]In a companion order, we today generally approve the BOCs' most recent ONA plan amendments detailing their provision of ONA services. *See* Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Phase I, FCC 91-382 (released December 19, 1991) . To the extent that parties argue that the CEI rules do not allow independent ESPs to purchase different or more advanced basic network services than those used in the provision of BOC enhanced services, *see, e.g.*, AccessPlus Comments at 9, these parties confuse our CEI and ONA requirements. As discussed above, the CEI regime was a transitional phase that provided ESPs with "equal access" to the underlying basic services used to provide BOC enhanced services. Reasonable access to different or new basic services desired by ESPs, however, is a requirement of ONA.

[106]The CEI parameters include: (1) interface functionality; (2) basic service unbundling; (3) resale; (4) technical characteristics; (5) installation, maintenance, and repair; (6) end user access; (7) CEI availability; (8) minimization of transport costs; and (9) CEI recipients. *See Phase I Order*, at 1021-1043, paras. 117-166. The ONA plans filed by the BOCs contain considerable detail on how the BOCs are to satisfy these parameters.

[107]*Phase II Order*, 104 FCC 2d at 1048-1049, paras. 174-175; *Phase I Second Further Reconsideration Order*, 4 FCC Rcd at 5927-5929, paras. 3-19.

time unspecified, architecture would be extremely costly and unnecessary for effective implementation of ONA.[108]

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[108] *BOC ONA Order*, 4 FCC Rcd at 41-43, paras. 69-72. We note that we are actively considering the public interest benefits of unbundling switching and transport in our *Expanded Interconnection* proceeding. Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Notice of Proposed Rulemaking and Notice of Inquiry, 6 FCC Rcd 4818 (1990).

The *Notice* also requested comment on the relationship between the nondiscrimination safeguards and LEC price cap regulation. *Notice*, 6 FCC Rcd at 180, para. 37. Only two parties discussed this issue. MCI stated that application of price cap regulation to ONA pricing would allow rate churn, making it difficult for ESPs to plan ahead in developing their own enhanced services. MCI Comments at 84. Furthermore, the DC PSC contends that price cap regulation may give the BOCs flexibility to price basic service elements (BSEs) that they use for their own enhanced services at lower rates than BSEs that they do not use. DC PSC Comments at 28-29. The Commission addressed these concerns in the *Part 69/ONA Order*, where we adopted a cost-based approach to the initial pricing of new ONA services, such as BSEs and basic services arrangements (BSAs). Under this approach, a LEC introducing new services must satisfy the net revenue test as well as submit, for example, engineering studies, time and wage studies, and other cost accounting studies to identify the direct costs of providing the new service. In addition, the BOCs were required to "flag" or identify the BSEs that they intend to use in their enhanced service operations. This requirement was adopted in order to prevent the BOCs from discriminating against independent ESPs by raising the rates of BSEs that their competitors use and decreasing the rates of BSEs that their own enhanced service operations use. *See* Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture and Policy and Rules Concerning Rates for Dominant Carriers, CC Docket Nos. 89-79 and 87-313, Report and Order & Order on Further Reconsideration & Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524, 4528, 4531-4533, paras. 23, 38-50.

2. *Nondiscrimination Reporting Requirements*

65. *Background.* In the *Phase II Order,* the Commission required the BOCs to file quarterly nondiscrimination reports.[109] Subsequently, the Commission required the BOCs to use a uniform format for their reports on the installation and maintenance of basic services and specified 48 basic service categories for reporting.[110] The Commission also modified the quality reporting requirement and required the BOCs to file annual affidavits attesting that they have not discriminated in the quality of services provided to enhanced service competitors.[111]

66. *Comments.* MCI argues that the nondiscrimination reporting requirements are no stronger than they were under structural separation, and that, absent a change in regulatory or market conditions, these requirements must be strengthened under nonstructural safeguards.[112] MCI and ADAPSO argue that the effectiveness of this safeguard relies on compliance by BOC employees and after-the-fact reporting, which is too arbitrary.[113]

67. *Discussion.* We conclude that our nondiscrimination reporting requirements adequately protect ESP competitors from discrimination in the installation, maintenance,

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[109]*See Phase II Order*, 2 FCC Rcd at 3082, 3084, paras. 73, 89.

[110]*BOC ONA Reconsideration Order*, 5 FCC Rcd at 3103, paras. 76-80.

[111]Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Phase 1, 4 FCC Rcd 1, 248-249, para. 481 (*BOC ONA Order*); 5 FCC Rcd 3084 (1990) (*BOC ONA Reconsideration Order*); 5 FCC Rcd 3103, 3120, para. 145 (*BOC ONA Amended Plans Order*). *See also Phase II Reconsideration Order*, 3 FCC Rcd at 1160, paras. 76-77.

[112]MCI Comments at 82-83.

[113]ADAPSO Comments at 12-15; MCI Comments at 86-88.

and quality of basic services. The nondiscrimination reporting requirements were adopted to protect against possible discrimination against ESPs by the BOCs in the quality, and installation and maintenance, of basic services. These requirements are designed so that the Commission can compare the level of service of basic services used in providing the BOCs' enhanced services with that of services used by their enhanced service competitors. During the past three years, we have reviewed the installation and maintenance reports filed by the BOCs. These reports indicate that the BOCs are installing and maintaining the basic services used in providing their own enhanced services in the same fashion and at the same rate as the basic services used by their competitors. We note that we have not received any complaints alleging that the BOCs are discriminating in the installation, maintenance, or quality of basic services. MCI does not point to any specific reasons as to why our nondiscrimination reporting requirements are ineffective. Based on our experience, we find that, within the ONA framework that the Commission has developed, they adequately protect against discrimination in the installation, maintenance, repair, and quality of basic services. We therefore readopt the nondiscrimination reporting requirements in effect before the *California* decision.[114]

3. *Network Disclosure Rules*

68. *Background.* In *Computer III* the Commission adopted network information disclosure rules to ensure that independent ESPs receive timely access to technical information related to new or modified network services affecting the interconnection of enhanced services to the BOC net-

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[114]This includes the requirement that the BOCs file annual affidavits attesting that they have not discriminated in the quality of services provided to their enhanced service competitors.

works.[115] These rules require that disclosure of network information to ESPs occur at the make/buy point, *i.e.*, when the carrier decides to make itself, or to procure from an affiliated entity, any product the design of which relies on the network interface. The BOCs were also required to release this information publicly at least twelve months prior to the introduction of the new service or network change. If a carrier was able to introduce the service between six and twelve months after the make/buy point, however, public disclosure was required at the make/buy point, but not less than six months before the introduction of the service.[116]

69. *Comments.* MCI argues that the network information disclosure requirement is no stronger than that under structural separation.[117] IDCMA further argues that these rules actually advantage the BOCs in their provision of enhanced services operations because public disclosure of network information is not required at the time the information is actually given to the BOCs' unregulated services personnel but, rather, at the make/buy point, which may be substantially later.[118] Several parties, including DOJ, NTIA, the Michigan PSC, and the Illinois Commerce Commission, support readoption of the network information disclosure rules.[119]

70. *Discussion.* We conclude that the *Computer III* network disclosure rules provide the enhanced services industry with critical network information in a timely fashion,

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[115]*Phase I Order*, 104 FCC 2d at 1080-1086, paras. 246-255.

[116]*See Phase II Order*, 2 FCC Rcd at 3087-3088, paras. 107-112.

[117]MCI Comments at 82-83.

[118]IDCMA Comments at 19, n. 25.

[119]NYNEX Comments at 83-84; Ameritech Comments at 22-23; Pacific Comments at 70; Michigan PSC Comments at 9-10, Illinois CC Comments at 5-6; NTIA Comments at 5-6; DOJ Comments at 7.

and thus serve as an effective safeguard against discrimination in the provision of basic services to competing ESPs. These rules generally require disclosure to independent ESPs at the make/buy point, which includes the time when the BOCs begin joint planning, research, or development of enhanced services that require new network services or changes to existing network services that affect the interconnection of enhanced services with the network.[120] Furthermore, any decision by the BOCs to manufacture or procure hardware or software for any service relying on the new or modified network interface would also trigger our disclosure requirements. We did not require disclosures to ESPs as soon as BOC personnel with any involvement with enhanced services are provided with network information. Such a disclosure rule would impair the carriers' development efforts, inhibit network improvements, and eliminate the benefits of removing structural separation by reinstituting the same types of artificial and inefficient restraints on internal information flows that are imposed by a structural separation requirement.[121] Such early disclosure of possible changes in the network could also cause significant difficulties if a BOC subsequently chose to follow a different course, giving rise to possible allegations of misconduct by ESPs who have relied on such preliminary information.[122]

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[120]*Phase I Order*, 104 FCC 2d at 1081, para. 252.

[121]*Phase I Order*, 104 FCC 2d at 1081, 1083-1084, paras. 248, 251-252. The same rules have also worked well when applied to the provision by the BOCs of basic services and unregulated customer premises equipment. Furnishing of Customer Premises Equipment by Bell Operating Telephone Companies and the Independent Telephone Companies, Report and Order, 2 FCC Rcd 143 (1987) (*BOC CPE Relief Order*), *mod'd on recon.*, 3 FCC Rcd 22 (1987) (*Reconsideration Order*).

[122]The State of Hawaii argues that GTE should be subject to the same nondiscrimination safeguards as are the BOCs because GTE is comparable to the BOCs and because Hawaii is served only by one carrier,

Again, MCI does not provide any specific reasons as to why the network disclosure rules are inadequate. Accordingly, we readopt the network disclosure rules in effect prior to the *California* decision.

4. *Capitalization Plan Requirement and Software Development*

71. *Background.* In *Computer II*, the Commission required the BOCs to file capitalization plans regarding the capital structure of the nonregulated affiliate.[123] The Commission eliminated the capitalization plan requirement in *Computer III.*[124] The Commission also in *Computer II* prohibited the regulated BOC company and its nonregulated affiliate from performing software development for one another.

72. *Comments.* No parties opposed the proposal in the Notice to eliminate the capitalization plan requirement or the prohibition against joint software development. On the other hand, several commenters express support for the removal of the capitalization plan requirement and the prohibition against the regulated company and the nonregu-

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GTE. Hawaii Comments at 3-8. GTE contends that it is not comparable to the BOCs in that it is comprised of a number of geographically dispersed LECs and that it is voluntarily complying in some respects with ONA and nondiscrimination safeguards. GTE Reply at 1-9; *Ex Parte* Letter, from Whitney Hatch, Assistant Vice President, Regulatory Affairs, GTE, to Donna R. Searcy, Secretary, FCC, November 12, 1991. Although this is an issue worthy of Commission consideration, it is beyond the scope of this proceeding to determine whether GTE should be subject to the same nondiscrimination requirements as the BOCs for GTE's provision of enhanced services.

[123] *Final Decision*, 77 FCC 2d at 485, para. 258.

[124] *See Phase I Order*, 104 FCC 2d at 1076-1077, paras. 238-240; *Phase II Order*, 2 FCC Rcd at 3098-3099, paras. 177-186.

lated affiliate from performing software development for one another.[125]

73. *Discussion.* We conclude that, in light of the implementation of our affiliate transaction rules and the burdens associated with the capitalization plan requirement, the filing of capitalization plans is no longer justified. We have no indication that the BOCs have improperly transferred assets from the regulated company to the separate subsidiary. Moreover, since *Computer II,* the Commission has implemented affiliate transaction rules that include asset valuation requirements to govern the transfer of assets to and from regulated and nonregulated affiliates. These rules specifically address the concerns mentioned in *Computer II* that resulted in the capitalization plan requirement. Under the affiliate transaction rules, asset transfers from the regulated company are recorded by the BOCs at net book cost or fair market value, whichever is higher. Thus, improper subsidies in the form of asset transfers will not flow from regulated ratepayer pockets to any separate nonregulated affiliate.

74. Similarly, we eliminate the prohibition against the BOCs' regulated company and any nonregulated affiliates performing software development for one another. The Commission's affiliate transaction rules specifically govern joint software development, and will adequately protect ratepayers from any disproportionate spreading of the costs of software development onto regulated activities. Transfer of services from the regulated company to the nonregulated company require that the affiliate pay the tariff rate, the prevailing price (determined by transactions with nonaffiliates) if there is no tariff rate, or fully distributed cost. These rules ensure that the unregulated affiliate does not

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[125] *See e.g.,* Pacific Comments at 70-71.

obtain special discounts or other improper price reductions to the detriment of regulated ratepayers.

C. *Customer Proprietary Network Information*

1. *Background*

75. Under the current CPNI rules for enhanced services, the BOCs' enhanced services marketing personnel are allowed to make use of CPNI without customer authorization, although a customer can request that its CPNI be withheld from such personnel. Independent ESPs, by contrast, must obtain advance authorization from the customer in order to obtain access to CPNI. The rules also require that the BOCs provide an annual written notice of CPNI rights to multiline business customers, and that any aggregated CPNI that a BOC makes available to persons involved in the marketing of enhanced services must also be made available to independent ESPs on the same terms.

76. The current CPNI rules for enhanced services were adopted in the *Phase II Order,*[126] and reaffirmed in the *Phase II Reconsideration Order.*[127] In the *BOC ONA Reconsideration Order,*[128] however, the Commission noted the continued concerns of ESPs about the competitive effects of the rules, and recognized that the manner in which the rules are implemented may affect whether a customer purchases BOC enhanced services before becoming aware either that independent providers exist or that those providers may have access to the customer's CPNI to structure a service offering to meet the customer's needs. Although we concluded that the CPNI rules were not properly before us at that

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[126]*Phase II Order,* 2 FCC Rcd at 3093-3098, paras. 141-176.

[127]*Phase II Reconsideration Order,* 3 FCC Rcd at 1161-1164, paras. 85-114.

[128]*BOC ONA Reconsideration Order,* 5 FCC Rcd at 3094, paras. 81-83.

time, we directed the BOCs to address any legitimate concerns of the independent ESPs in the April 1991 amended ONA plans.

77. In the *Notice,* we decided to expand and accelerate our review of the CPNI safeguards applicable to BOC provision of enhanced services. We requested comments both on proposals for improving the implementation of the CPNI rules, and on modifications to the rules, including specifically a prior authorization requirement to be applied to the BOCs in some or all circumstances.[129] The *Notice* specified that any proposals should balance considerations of efficiency, competitive equity, and customer privacy.

2. *Comments*

78. Parties seeking modification of the current CPNI rules focus largely on the issue of competitive equity. Independent ESPs and others argue that the current CPNI rules give the BOCs a significant competitive advantage.[130] For instance, parties assert that the BOCs can use their access to CPNI: (1) to identify new customers before anyone else and to contact those customers before they realize that there are competitive alternatives; (2) to target the customers of competing ESPs; (3) to tailor their marketing presentations based on information about customers' network usage; and

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[129]*Notice,* 5 FCC Rcd at 180, paras. 38-40.

[130]ADAPSO Comments at 35-36; ANPA Comments at 40-45; ATSI Comments at 10-16; ONA Users Group Comments at 6-9; CompuServe Comments at 32-33; Iowa Network Services Comments at 32-35; California Comments at 9-10; Colorado Comments at para 7; DC Public Service Commission Comments at 29; Florida Comments at 12-13; NARUC Comments at 15; New York Comments at 11-12; Pennsylvania Comments at 11-14; Sprint Comments at 3-4; IDCMA Comments at 18; MessagePhone Comments at 15; IIA Comments at 6-15.

(4) to identify the appropriate customer contact.[131] Some parties argue in particular that the current rules give the BOCs the opportunity to try to sell enhanced services to customers who contact them to purchase basic services for use in conjunction with a competing ESP's services.[132] Moreover, some parties contend that many customers do not understand, or simply ignore, the CPNI notices currently provided to multiline business customers, suggesting that these notices are an ineffective response to competitive concerns.[133]

79. Some ESPs argue specifically that the current rules do not provide sufficient protection for their own CPNI or that of their customers. For instance, ATSI asserts that although an ESP is permitted to restrict BOC access to its CPNI, the BOCs discourage restrictions by telling ESPs who do so that they can no longer do business with the account executives familiar with their business needs.[134] With regard to the CPNI of the ESPs' customers, Iowa Network Services proposes that the Commission prohibit the BOCs from releasing such CPNI to the BOC enhanced

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[131]*See e.g.,* ANPA Comments at 40-42; ATSI Comments at 10-11; Iowa Network Services Comments at 32-35; IIA Comments at 6-15; Florida Comments at 12-13.

[132]ATSI Comments at 12-15.

[133]TCA Comments at 6-7. *See also* U S West Comments at 72-75; Ameritech Comments at 27-28.

[134]ATSI Comments at 16-18. Pacific responds that under a prior authorization requirement, all customers that do not authorize access to CPNI will suffer the same inconvenience of which ATSI complains because these customers would need to be transferred from their current account executives to network-services-only account executives. Pacific Reply at 38-39. TCA argues that the BOCs should not only be subject to a prior authorization rule, but should also be prohibited from assigning enhanced service marketing functions to their network service account teams. TCA Comments at 7-8.

services operations without the consent of the ESP, in order to prevent the BOCs from identifying and marketing enhanced services to the ESPs' customers.[135] A number of large customers express concern over unrestricted BOC access to CPNI, arguing that CPNI can be competitively sensitive from the customer's point of view.[136]

80. The BOCs respond to competitive equity arguments in a number of ways. The BOCs argue that CPNI does not provide them with a significant advantage in identifying customers.[137] Some of the BOCs also contend that CPNI cannot easily be used to generate lists of potential customers,[138] or that independent ESPs have access to much better marketing data from other sources, such as their own customer records or publicly sold marketing lists.[139] The BOCs also argue that CPNI has little value because ESPs make very few requests for CPNI.[140] Some of the BOCs assert that they have addressed certain ESP competitive equity concerns internally. For instance, some BOCs permit ESPs to order network services for their ESPs' customers, thereby minimizing the BOC's contact with those custom-

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[135]Iowa Network Services Comments at 34.

[136]AAR Comments at 2; ICA Comments at 15; TCA Comments at 4; UTC Comments at 4-6; ONA Users Group Reply at 2-4.

[137]Ameritech Reply at 20-21; Bell Atlantic Comments at 15-18; BellSouth Comments at 33-34; NYNEX Comments at 60-62; Pacific Comments at 58-59; SWBT Comments at 49-50.

[138]SWBT Reply at 49-51.

[139]*See* Bell Atlantic Comments at 16-17; *see also* Pacific Comments at 58-63, SWBT Comments at 49.

[140]*See* Bell Atlantic Reply at 13; BellSouth Reply at 33; Pacific Comments at 60. ***But see*** Sprint Reply at 6 (low number of requests for CPNI may reflect difficulty of obtaining customer authorizations, not the low value of the information).

ers.[141] In addition, BellSouth and Pacific state that they have instructed their service representatives not to market enhanced services to customers when they call to order network services for use with another ESP's service.[142]

81. Finally, the BOCs argue that their access to CPNI is no different from an unregulated company's access to its customer records and should therefore be permitted. Ameritech asserts that the antitrust laws prove that the BOCs' use of CPNI does not give them an unfair competitive advantage, citing *Catlin v. Washington Energy Co.*[143] as holding that a natural gas utility was free to use its customer list to market gas-related products in competition with others.[144]

82. On the issue of privacy, differing views were expressed on whether the BOCs' use of CPNI is in accord with customers' expectations. The BOCs assert that people generally expect the companies with which they have an ongoing business relationship to have information about their past transactions, and to use that information occasionally to market new services to them.[145] Some of the BOCs argue as well that customers will actually be upset if all BOC personnel do not have access to their records.[146] Other parties, however, challenge the BOCs' assertion that the

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[141]BellSouth Comments at 33-34.

[142]BellSouth Comments at 33-34; Pacific Comments at 52.

[143]791 F.2d 1343 (9th Cir. 1986).

[144]Ameritech Reply at 20.

[145]Ameritech Comments at 26; BellSouth Reply at 41; NYNEX Comments at 57-60, Appendices A & B; Pacific Comments at 54-55; SWBT Comments at 51; U S West Comments at 70-71.

[146]BellSouth Reply at 49 (Florida customers subject to prior authorization have complained about BOC personnel inability to access account information); *see also* NYNEX Comments at Appendix A, pp. 28-29; Pacific Comments at 54-55.

current rules are in accord with customers' privacy expectations.[147]

83. With regard to efficiency, the BOCs and USTA argue that any prior authorization requirement will effectively impose structural separation on their enhanced services marketing activities, asserting that a prior authorization rule would require the use of separate sales forces for basic and enhanced services.[148] BellSouth states that as a result of a Florida rule requiring prior authorization for BOC-initiated contacts, the cost of reaching the mass market is higher, and fewer customers are being contacted and offered services from which they might benefit.[149] Other commenters argue that the BOCs have exaggerated the difficulty of structuring their workforces to comply with a prior authorization rule[150] and of obtaining customer consent to access CPNI, particularly in view of the BOCs' assertions that customers do not object to BOC use of their CPNI.[151] Sprint suggests that to the extent prior authorization does result in some loss of efficiency, prior authorization should not necessarily be rejected, as efficiency is only one of the policy objectives cited by the Commission.[152]

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[147]*See e.g.*, ATSI Reply at 12; ONA Users Group Comments at 4-6, Reply at 2-4; ANPA Comments at 43; Pennsylvania Comments at 13; Alarm Industry Comments at 10-11.

[148]Ameritech Comments at 25-26; Bell Atlantic Comments at 15; BellSouth Comments at 30-32; NYNEX Comments at 51-52; Pacific Comments at 49-54; USTA Reply at 18-21.

[149]BellSouth Reply at 47-50.

[150]*See* ONA Users Group Reply at 4; DC Public Service Commission Reply at 10-11; TCA Reply at 10.

[151]McGraw-Hill Reply at 14-15; DC Public Service Commission Reply at 10-11; TCA Reply at 10.

[152]Sprint Reply at 4-5.

3. *Discussion*

84. The CPNI rules for enhanced services were intended to balance considerations of efficiency, competitive equity, and privacy. Having had the opportunity to monitor the operation of the CPNI rules since their adoption, we now conclude that a change in those rules is appropriate to better balance these three important interests. Accordingly, we will require that, for customers with more than twenty lines, BOC personnel involved in marketing enhanced services obtain written authorization from the customer before gaining access to its CPNI.

85. The current rule enables the BOCs to engage in integrated marketing and sales of basic and enhanced services, thereby providing a number of benefits, especially in developing a mass market for enhanced services. Permitting the BOCs greater freedom in marketing enhanced services to residential and smaller business customers can help to increase the customers' knowledge about such services. BOC marketing efforts that make consumers more aware of the benefits of enhanced services should expand the market for such services, benefitting both consumers and ESPs.[153] The integrated marketing to consumers and smaller businesses made possible by the current CPNI rule not only allows the BOCs to provide basic and enhanced services more efficiently, but also provides direct benefits to customers in the form of "one stop shopping." For instance, without the integrated marketing and sales made possible by our CPNI rules, if a customer called the telephone company to discuss basic network services, such as additional lines or call waiting, and then wanted merely to get information about an enhanced service, such as voice mail, he would have to be transferred to a separate enhanced services representative who would likely ask him to repeat much of

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[153]*See Phase II Reconsideration Order*, 3 FCC Rcd at 1162, para. 97.

the information that he had already provided.[154] With integrated marketing and sales, the BOC service representative receiving a call can also offer consumers additional choices that may better suit their needs, including combinations of basic and enhanced services. For instance, a customer service representative might suggest a voice mail service to record messages when the customer's line is busy as a more economical alternative to ordering additional lines. If a prior authorization rule were applied to all customers, only the largest business customers would be able to enjoy the one-stop-shopping benefits of the integrated marketing of basic and enhanced services.[155]

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[154]That this is the likely result of a prior authorization requirement is confirmed by the ONA Users Group, who, in arguing that the BOCs could easily comply with a prior authorization requirement, asserts that the BOCs could have regulated service personnel respond to all general inquiries, and refer to enhanced services personnel any inquiries about enhanced services. ONA Users Group Reply at 4. *See also* TCA Comments at 10.

[155]Applying a prior authorization rule for other than the largest customers likely would require a BOC to establish separate enhanced and basic service marketing forces for those customers. Unlike the largest business customers, which are likely to have relatively frequent contacts with their local BOCs through telephone company representatives specifically assigned to them, mass market customers commonly have only sporadic contacts with BOC telephone personnel, calling blind into the BOC's business office whenever they have questions or desire services from the telephone company. Thus, the BOCs can be expected to staff their business offices with personnel able to respond to most customer's basic services inquiries. If a customer has restricted CPNI, whether through action or inaction, then for basic services that customer must deal with "network-services-only" personnel, i.e., those with no involvement with enhanced services marketing or sales, because only those personnel are permitted under the Commission's CPNI rules to have access to restricted CPNI. Under a prior authorization rule, a large majority of mass market customers are likely to have their CPNI restricted through inaction, and in order to serve them the BOCs would have to staff their business offices with network-services-only represent-

86. The current rules do raise some competitive issues, however. In this proceeding, most commenters argue for greater restrictions on BOC access to CPNI, and the record indicates that their unrestricted access to CPNI does give the BOCs an advantage over competing ESPs in marketing enhanced services to BOC customers. This advantage is of particular importance with respect to large business customers, as their CPNI is most likely to be of competitive value, due to the volume and nature of business involved.[156] The CPNI of large business customers raises competitive issues not only for ESPs competing with the BOCs, but also for the customers themselves. Some large business customers have expressed concern about the competitive implications for them of unrestricted BOC access to their CPNI, [157] suggesting that CPNI records can reveal sensitive marketing strategies, expansion plans, innovative uses of telecommunications, customer lists, costs, and other confidential business information and therefore should not be revealed to anyone, including the BOCs' enhanced services operations, without the customer's consent.[158] At the same time, the BOCs are most likely to be able to obtain prior authorization from

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atives, and establish separate marketing and sales forces for enhanced services. Thus, a prior authorization rule would vitiate a BOC's ability to achieve efficiencies through integrated marketing to smaller customers — one of the benefits sought through adoption of nonstructural safeguards rather than structural separation.

[156]*See Phase II Order*, 2 FCC Rcd at 3096, para. 164.

[157]ICA Comments at 14-15; TCA Comments at 3-5. The Utilities Telecommunications Council indicated that utilities are very concerned about the security of their communications services, and limit the information that they reveal even to the telephone companies on a strict "need to know" basis. UTC Comments at 5.

[158]For instance, AAR indicates that some customers may want to restrict CPNI access to lessen the danger that their network design and usage patterns might be disclosed to competitors. AAR Comments at 2. TCA argues that as the BOCs enter unregulated businesses, they will

those customers because the BOCs in many cases already have established special sales relationships with them. Accordingly, a prior authorization rule for large business customers will achieve complete competitive equity for a valuable market segment while leaving intact the public interest benefits of joint marketing for smaller customers and not severely disrupting those for large business customers either. We will therefore change the CPNI rules to require prior authorization for customers with more than twenty lines.[159]

87. In order to provide additional safeguards in those areas where competitive concerns are greatest while at the same time minimizing the extent to which the benefits to be derived from the current rules are diminished, we must identify that group of large business customers whose CPNI should be subject to prior authorization. The record does not reflect a consensus as to what would be the best method, and there may be varying administrative burdens on the BOCs to implement any approach to defining large business customers because the BOCs have established different internal definitions of large business customers and marketing organizations to serve them. Parties have suggested different methods by which such customers could be identified, such

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find themselves increasingly in competition with their customers. TCA Comments at 4.

[159]We note that although customer privacy has always been one of the Commission's concerns in addressing CPNI, our focus in this order is on competitive equity and efficiency. To the extent that CPNI is available to BOC personnel involved in marketing enhanced services, information is available only within a single integrated company, and we do not believe that such internal BOC access to CPNI generally raises significant privacy concerns. Although privacy concerns are implicated by disclosure of CPNI to third parties outside the BOC, the CPNI rules have always protected against such disclosure. A more extensive prior authorization rule is not necessary to protect customers' privacy interests.

as a number of lines test,[160] or an external source such as the Fortune magazine rankings of companies by size.[161] External sources do not take account of a customer's use of telecommunications services in the way that a number of lines approach does, and it is the use of communications services that is significant for our purposes. We therefore conclude that a number of lines test is more effective. While the BOCs all oppose any prior authorization rule, three have suggested in the alternative that we impose a prior authorization requirement for customers of 50 or more lines, while one has suggested a prior authorization requirement for customers of more than 20 lines.[162] We conclude that BOC personnel involved in enhanced services marketing should obtain prior authorization before accessing the CPNI of customers with more than twenty lines. This rule preserves the benefits of our current rules for the further development of enhanced services for the mass market, while providing additional safeguards with respect to those customers whose CPNI might provide the greatest competitive advantage to the BOCs and raises competitive issues for the customers themselves.[163]

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[160]*Ex Parte* Letter from Gary L. Dennis, Director, Federal Regulatory, BellSouth, to Donna R. Searcy, Secretary, FCC, November 1, 1991.

[161]*Ex Parte* Letter from Shelley E. Harms, Attorney, NYNEX, to Donna R. Searcy, Secretary, FCC, October 10, 1991.

[162]*See e.g., Ex Parte* Letters from Elridge A. Stafford, Director, Federal Relations, U S West, to Patrick Donovan, Attorney, FCC, November 4, 1991; Gary J. Dennis, Director, Federal Regulatory, BellSouth, to Donna R. Searcy, Secretary, FCC, November 1, 1991; and Shelley E. Harms, Attorney, NYNEX, to Donna R. Searcy, Secretary, FCC, October 10, 1991.

[163]To the extent that customers may have more than twenty lines distributed among multiple locations, each of which has fewer than twenty, the BOCs should treat these customers as subject to the prior authorization rule if it is practically feasible to identify them as having

88. Some of the BOCs question whether the Commission may change the CPNI rules, asserting that there are no changed circumstances to justify such a decision.[164] The Commission, however, does have the authority and, indeed, the obligation to reexamine its regulatory policies to ensure that they continue to serve the public interest. "An agency is not prohibited from changing its mind. '[F]aced with new developments or in light of reconsideration of the relevant facts and its mandate, [the agency] may alter its past interpretation and overturn past administrative rulings and practice.' "[165] Having concluded that the public interest would be better served by the rules adopted in this Order, we are not only authorized but obligated to change our rules.

89. Accordingly, we are amending our CPNI requirements to provide that BOC personnel engaged in the marketing of enhanced services may not access the CPNI of customers with more than twenty lines unless they have obtained the permission of the customer. We require the BOCs to implement this requirement six months from the date of this *Report and Order*.[166] We will require that the

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more than twenty lines in total. Where the BOC treats several locations as belonging to the same customer for other purposes, it should do so for CPNI as well, unless good cause is shown for doing otherwise. In any event, we require that, in implementing the CPNI rule, the BOCs must treat a customer as having more than twenty lines whenever the customer has more than twenty lines at one location.

[164]*See* Bell Atlantic Comments at 15; SWBT Comments at 57; U S West Comments at 30.

[165]*Spartan Radiocasting Co. v. FCC*, 619 F.2d 314, 322 (1980), citing *American Trucking Ass'n v. Atchison, Topeka and Santa Fe Railway Co.*, 387 U.S. 397, 416 (1967).

[166]In our companion order, we require each BOC to file an amendment to its ONA plans describing, *inter alia*, changes to its CPNI procedures necessary to implement our revised CPNI rule. *See* Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Phase I, FCC 91-382, at para. 54 (released December 19, 1991).

BOCs implement our revised prior authorization rule in a nondiscriminatory manner. The CPNI rules for enhanced services as they apply to other customers remain unchanged.[167] By continuing to permit the BOCs' enhanced services operations to have access to the CPNI of most customers, we are not authorizing the practice of "unhooking," the targeting of enhanced service sales pitches at customers who contact the BOC to order network services to use with a competitor's enhanced service.[168] We find that practice to constitute an abuse of the BOCs' positions as providers of basic services, and will investigate claims that any BOC is engaging in such a practice.

D. *Public Interest Analysis*

1. *Background*

90. Using a cost/benefit analysis, the Commission concluded in *Computer III* that, when compared to nonstructural safeguards, a structural separation requirement for BOC provision of enhanced services imposed significant costs on both the BOCs and the public. Those costs included decreased efficiency, innovation, and service availability caused in part by the requirement for BOC duplication of facilities and personnel as well as by limitations on joint marketing. The Commission found that, relative to non-

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[167]For instance, the notification requirement remains in place for those multiline business customers whose CPNI is not subject to prior authorization. In addition, the rules regarding the use of aggregated CPNI and disclosure of CPNI to independent ESPs remain unchanged. Similarly, the rules applicable to the use of CPNI in marketing CPE are not affected by this Order.

[168]In the Matter of the Commission's Investigation into Southern Bell Telephone and Telegraph Company's Provision of Memory Call Service, Order of the Commission, Georgia Docket No. 4000-U (June 4, 1991).

structural safeguards, the costs of structural separation outweighed the benefits.[169]

91. The *California* Court, however, vacated the *Computer III* decision because it concluded that the Commission had not presented sufficient justification for reliance on cost accounting safeguards to guard against cross-subsidization so soon after the Commission's decision in the *BOC Separation Order* to continue structural separation for BOC enhanced services. Despite the remand, the Court upheld the fundamental *Computer III* determination that BOC structural separation requirements impose significant public interest costs. The Court observed that the record in that proceeding supported the conclusion that lifting the structural separation requirements would benefit consumers of enhanced services by permitting the BOCs to operate more efficiently in the enhanced services market. The Court said the record supported the Commission's finding that "the BOCs have had to raise the price of certain services, withhold others from the market, and perhaps never develop still others because of the inefficiencies of structural separation."[170] Moreover, the Court stated that the Commission showed that "the integration of regulated and unregulated telecommunications services by the BOCs would yield some economies of scale."[171]

2. *Comments*

92. Most commenters in this proceeding either support, or do not oppose, institution of nonstructural safeguards for BOC provision of enhanced services. NTIA, DOJ, and IBM, for example, strongly support reinstatement of nonstructural safeguards rather than a structural separation

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[169] *Phase I Order*, 104 FCC 2d at 1011-1092.

[170] *California*, 905 F.2d at 1231.

[171] *Id.*

requirement.[172] GSA also opposes any rule that would preclude or inhibit the physical integration of enhanced services into the facilities and equipment that provide basic services.[173]

93. The BOCs generally contend that the American public will benefit as a result of the efficiencies of integrated offerings of basic and enhanced services.[174] They argue that experience with structural separation demonstrates that it hinders the introduction and development of enhanced services, which would otherwise benefit the public by being widely available through the BOCs' local exchanges. They contend that a structural separation requirement imposes direct costs because it mandates the duplication of facilities and personnel and limits joint marketing. The BOCs assert that the biggest cost of structural separation is that, without integration, most enhanced services would not be offered to the mass market in the foreseeable future.[175]

94. The BOCs claim that the removal of BOC structural separation already is producing the benefits anticipated by the Commission, as shown by BOC experience with voice mail in the mass market.[176] According to NYNEX, the LECs are the one industry segment with the resources, experience, and established relationships to educate the

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[172]NTIA Comments at 6-7; DOJ Comments at 4-7; IBM Comments at 2-5.

[173]GSA Reply at 20; *see also* Illinois CC Comments at 7.

[174]Bell Atlantic Comments at 7; BellSouth Comments at 5-14; NYNEX Comments at 9-11; Pacific Comments at 5-7; SWBT Comments at 6; U S West Comments at 18-25; Bell Atlantic Reply at 5; BellSouth Reply at 10-14; Pacific Reply at 3-13.

[175]*See e.g.*, Pacific Reply at 9, SWBT Reply at 30; NYNEX Reply at 5.

[176]*See e.g.*, Pacific Comments at 5-13; Bell Atlantic Comments at 3-9; NYNEX Comments at 11-12; Bell Atlantic Reply at 5.

average consumer about the availability and advantages of enhanced services, and to develop and offer integrated packages tailored for small business and residential customers' needs.[177] They further assert that integration benefits business competitiveness and productivity generally, as well as increases availability of other enhanced services.[178]

95. Commenters urging adoption of a structural separation requirement claim that the risk of successful anticompetitive conduct by the BOCs under nonstructural safeguards outweighs any possible benefits of integrated provision of interstate basic and enhanced services.[179] Some commenters argue that the *Notice's* cost/benefit analysis places too much weight on the perceived efficiencies resulting from removal of structural separation, and too little on the protection it offers to consumers and competition.[180] They also argue that a structural separation requirement would be much easier to enforce.[181]

96. Commenters favoring a structural separation requirement claim that its elimination is not required to bring enhanced services to the public, and will not result in the BOCs providing more, or innovative, enhanced services.[182] These parties claim that there is no record support that there are any efficiencies available from integration, that the price of enhanced services will rise without integration, or that

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[177]NYNEX Comments at 11.

[178]U S West Comments at 18-25; Ameritech Comments at 7-8.

[179]*See e.g.*, Ad Hoc Comments at 19-27; MCI Comments at 29-30; ANPA Reply at 2; CompuServe Reply at 3-6.

[180]CompuServe Comments at 12.

[181]*See e.g.*, ADAPSO Comments at 9-12; MCI Comments at 94-95; IDCMA Reply at 3.

[182]CompuServe Comments at 13; MCI Comments at 10, 12-13.

structural separation imposes significant costs.[183] Several parties contend that Ameritech's provision of enhanced services through separate subsidiaries and that the provision by other BOCs, such as Pacific Bell, of certain enhanced services through separate subsidiaries proves that structural separation imposes no costs and that nonstructural safeguards have no real benefits for BOC provision of enhanced services.[184] ADAPSO suggests that structural separation could be flexibly implemented to allow integration whenever BOCs can demonstrate real benefits through a waiver process.[185]

97. In reply, the BOCs dispute contentions that enhanced services are widely available to the mass market. They assert instead that the availability and quality of enhanced services for residential and small business consumers are still far behind several industrial nations in Europe and Asia.[186] They also disagree that a return to the *Computer II* waiver process would be a viable alternative to nonstructural safeguards since this would introduce unwarranted delay and other costs into the delivery of new services.[187]

3. *Discussion*

98. As set forth above in detail, we have developed a set of strengthened nonstructural safeguards that will protect against cross-subsidization and discrimination. We conclude

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[183]Ad Hoc Comments at 19-27; ANPA Comments at 24; CompuServe Comments at 10; DC PSC Comments at 3-9, MCI Comments at 10-14; Pennsylvania PUC Comments at 4; ANPA Reply at 7; CompuServe Reply at 8; IDCMA Reply at 2.

[184]MCI Comments at 8-16, 35-38.

[185]ADAPSO Comments at 31.

[186]*See e.g.* Pacific Reply at 4.

[187]NYNEX Reply at 9; U S West Reply at 34-35.

that permitting the BOCs to participate in the enhanced services industry pursuant to this set of safeguards will not result in significant public interest costs. The benefits, in contrast, are substantial and lead us to conclude that on balance, the public interest is better served by eliminating the structural separation requirement. We find that this approach will permit the BOCs to use their resources more efficiently to provide enhanced services, resulting in the wider availability of enhanced services to the public, while effectively ensuring that BOC participation in enhanced services does not adversely affect basic service rates or harm ESPs due to BOC anticompetitive conduct.

99. Contrary to the assertions of some commenters, we conclude that the BOCs hold great potential for providing a wide variety of enhanced services throughout the country, especially on a mass market basis. The BOCs own, manage, and control an important portion of our nation's telecommunications assets and resources, including not only communications facilities, but also the associated management and operational resources essential for providing all kinds of communications services feasible with existing and emerging technologies. These resources provide the BOCs with a substantial foundation for providing such communications-based services as enhanced services. For example, the geographic dispersion of facilities throughout the BOC regions makes it possible for the BOCs to serve many communities not economic for others. The BOCs' existing marketing contacts with customers provide a ready, inexpensive opportunity for the marketing of enhanced services.[188] In addition, because the BOCs already serve large numbers of households in their respective regions, they have a substantial ability to use their existing assets and resources to provide enhanced services to the consumer market.

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[188]BellSouth states that it has millions of marketing contacts annually with customers. BellSouth Comments at 42.

100. We conclude as well that the BOCs cannot fully realize their potential in the enhanced services marketplace unless they are permitted to capture the legitimate efficiencies available to them. Provision of enhanced services on an integrated basis with basic services can result in operational efficiencies, economies of scope, and cost savings by avoidance of separation and/or duplication of assets and personnel required by a regulatory requirement for structural separation. For example, the BOCs can be more efficient by: (1) using existing sales contacts to market enhanced services rather than establishing new, separate sales forces;[189] (2) using the same personnel to repair and install equipment used to provide basic and enhanced services rather than using different personnel;[190] and (3) using existing expertise in research and development that may have application to enhanced and basic services rather than seeking to do so separately for enhanced services.[191] The existence of such potential efficiencies is confirmed both by the history of the enhanced services market and by the record in this proceeding.

101. Since *Computer II* and the *BOC Separation Order*, the Commission has gained substantial experience with application of both structural separation and nonstructural safeguards as regulatory frameworks governing BOC provision of enhanced services. That experience demonstrates that, relative to nonstructural safeguards, mandatory structural separation has significantly dampened BOC provision

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[189]*See e.g.*, NYNEX Comments at 11-14, 18; Pacific Comments at 4, 24; SWBT Comments at 16; U S West Comments at 16.

[190]*See e.g.*, NYNEX Comments at 17-20; SWBT Comments at 13-14.

[191]*See e.g.*, NYNEX Comments at 14-17; U S West Comments at 16; SWBT Comments at 10-12, 16.

of enhanced services.[192] During the *Computer II* regime and prior to our CEI requirements, most BOCs provided few enhanced services, and only then subject to waivers of *Computer II* granted after lengthy proceedings.[193] *Computer III* pointed to the *Custom Calling Denial Order* as evidence of the impact of structural separation on the likelihood of the BOCs providing enhanced services to the public.[194] In that decision, the Commission denied the request of AT&T (which then included the BOCs) for waiver of the *Computer II* requirement for structural separation to provide network-based voice mail services based on the view that, even if AT&T were not permitted to integrate the voice storage and retrieval feature into its basic service offerings, competitors would offer comparable services. However, no fully comparable services were offered.[195] Thus, structural separation appears, as a practical matter, to have completely foreclosed the offering of this service to the public. The BOCs also provide specific examples of new

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[192]In the first triennial review of the *MFJ*, the District Court modified the information services restriction to permit the BOCs, *inter alia*, to provide voice storage and retrieval services. United States v. Western Electric Co., 673 F.Supp. 525 (D.D.C. 1987); United States v. Western Electric Co., 714 F.Supp. 1 (D.D.C. 1988); 767 F.Supp. 308 (D.D.C. 1991).

[193]Petitions for Waiver of Section 64.702 of the Commission's Rules (Computer II), *Memorandum Opinion and Order*, 100 FCC 2d 1057 (1985).

[194]American Telephone and Telegraph Co. Petition for Waiver of Section 64.702 of the Commission's Rules and Regulations, 88 FCC 2d 1 (1981).

[195]Telephone answering machines and telephone answering service bureaus provide very valuable types of voice storage and retrieval services. In *Computer III* we stated that the distinguishing characteristic of network based voice mail services is their ubiquity and their easy availability to casual users. *Phase I Order*, 104 FCC 2d at 1112, para. 313.

services that have been affected by the imposition of a structural separation requirement after the *California* decision.[196]

102. By contrast, our experience with nonstructural safeguards shows that removal of structural separation requirements has resulted and will result in greater BOC participation in the provision of enhanced services. Under CEI plans, the BOCs have participated to a much greater degree in providing enhanced services than under structural separation. For instance, under CEI plans or market trials, the BOCs have provided, or sought to provide, voice mail service, E-mail, gateways, electronic data interchange, data processing, voice store-and-forward, and fax store-and-forward services. Some of these services have been of an experimental nature, such as gateways, confirming our view in *Computer III* that the BOCs can bring innovative enhanced services to the public.

103. BOC experience with voice mail has been particularly telling. Since the BOCs have been permitted to provide voice storage and retrieval services under nonstructual safeguards, they have vigorously competed in the provision of voice mail service at a reasonable price to consumers. As of the time of filing comments in this proceeding, Bell Atlantic provided its voice mail service to nearly 120,000 subscribers after one year of general availability.[197] It expected this number to grow to 350,000 subscribers in 1991. NYNEX's

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[196]U S West, for example, states that it has foregone development of its proposed fax store and forward service since the reimposition of the *Computer II* regime following the Ninth Circuit decision. U S West Comments at 26. NYNEX states that the future of certain enhanced services that were in the planning and development stage when the Court vacated *Computer III* is now uncertain since it is unclear when, if ever, they may be pursued on an integrated basis. NYNEX Comments at 20, n. 32.

[197]Bell Atlantic Comments at 4.

voice mail service was available to over 850,000 access lines.[198] U S West provided voice mail service to approximately 200,000 subscribers.[199] Pacific, which makes use of an integrated sales force in the marketing of its voice mail service, provided service to 2000 new residential customers each week during the first three months that it offered the service.[200] Contrary to assertions of some commenters, this participation is substantial within the timeframe during which the BOCs have been allowed to provide voice mail service pursuant to nonstructural safeguards.[201]

104. Generally confirming our conclusions of the significant efficiencies and economies of scope that could be gained from integrated provision of basic and enhanced services are BOC estimates of the costs of a structural

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[198]NYNEX Comments at 13.

[199]U S West Comments at 21-22.

[200]Pacific Comments at 8.

[201]BOC participation in the enhanced services marketplace has not injured competition. The BOCs report that voice mail services show solid trends of increasing output and decreasing price. The BOCs estimate that overall, the market for voice mail services grew between 1988 and 1989, with total revenues rising from $452 million to $635 million. *See* BOC Reply Memorandum filed in *United States of America v. Western Electric Company, Inc., and AT&T* (Civ. No. 82-0192), Appendix, Exhibit A citing "European, U.S. Voice Messaging Grow at Very Different Rates." *FinTech Telecom Markets* (September 20, 1990). Moreover, the BOCs further state that in the two years they have participated in the provision of voice mail services, the voice mail equipment market has grown threefold; prices have declined; the number of voice mailboxes has grown from 5.3 million to 11.6 million; and the market for voice mail services has increased by 40 percent from $452 million to $635 million. BOC Reply Memorandum, Table A-5. Similarly, in the two years that the BOCs have provided videotext gateways, total subscribers to all videotext gateways have increased from 715,000 to 1.8 million and are continuing to multiply at a rate of 15-20 percent each year. BOC Reply Memorandum, Table A-11.

separation requirement.[202] Operational efficiencies in some of these areas may be essential to serving the consumer market. Pacific Bell and U S West have estimated that the one time costs for transferring and/or duplicating facilities and personnel could be as high as $10-$15 million for structurally separate provision of voice mail services.[203]

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[202]*See e.g.*, U S West Comments at 17-28; Ameritech Comments at 3-4; Bell Atlantic Comments at 3; BellSouth Comments at 5-13; NYNEX Comments at 9-10; SWBT Comments at 6-12. *See also* Unisys Comments at 3; NTIA Comments at 6-7. We reject the view of some commenters that we may not, or should not, consider the BOCs' estimates of cost savings and efficiencies of integration because the underlying data have not been submitted and cannot be verified, and because the estimates of efficiencies vary among the BOCs. *Ex Parte* Letter from Frank W. Krogh, Appellate Counsel, Regulatory Law, MCI, to Donna R. Searcy, Secretary, FCC, November 12, 1991; *Ex Parte* Letter from Warner Sinback, Chairman, Domestic Communications Committee, Information Technology Association of America, to Donna R. Searcy, Secretary, FCC, November 13, 1991. While the BOCs have not submitted complete substantiation of their estimates of cost savings and efficiencies, the information submitted is sufficient to confirm and support our finding that allowing the BOCs to participate in the enhanced services market pursuant to nonstructural safeguards will achieve efficiencies and economies of scope. For instance, some of the BOCs have provided information as to how they arrived at these estimates and, in some cases, have provided a categorization and quantification of the types of costs and revenues that were used in estimating the cost savings of integration. *See e.g., Ex Parte* Letter from Trudi W. Blair, FCC Relations, Bell Atlantic, to Donna P. Searcy, Secretary, FCC, November 7, 1991. Commenters have not shown that the manner in which these BOCs arrived at their estimates has precluded their use as evidence confirming the other record information that nonstructural safeguards would permit the BOCs to operate more efficiently in the enhanced service marketplace than would structural separation. We also find that the range of specific BOC estimates does not undermine their confirmation of our broad public interest finding of the efficiency benefits of nonstructural safeguards.

[203]*Ex Parte* Letter from Celia Nogales, Federal Regulatory Relations, Pacific, to Donna R. Searcy, Secretary, FCC, September 20, 1991; *Ex*

Various BOCs estimate that the costs of providing some enhanced services under structural separation could be up to 68%[204] higher than under integration and necessitate price increases of as much as 30%[205] and 80%.[206] U S West estimates that increased marketing expenses alone under structural separation would increase the price of its voice mail service by 30%.[207] The BOCs state that marketing studies reveal that at this level of price increase there would be a significant decline in demand for some enhanced services rendering them uneconomical to provide.[208]

105. We therefore find that the BOCs hold great potential for providing enhanced services, and that the use of nonstructural safeguards in lieu of structural safeguards permits a fuller realization of that potential. We conclude that a major benefit of adopting nonstructural safeguards is that this course would permit the BOCs to take advantage of operational efficiencies of integration, facilitate BOC provision of enhanced services, engage in joint marketing of basic and enhanced services, and will result in a greater provision of enhanced services, especially in the mass market.[209] By

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Parte Letter from Elridge A. Stafford, Director, Federal Relations, U S West, to Donna R. Searcy, Secretary, FCC, September 26, 1991.

[204]*Ex Parte* Letter from William A. Blase, Director, Federal Relations, Southwestern Bell, to Donna R. Searcy, Secretary, October 11, 1991.

[205]*Ex Parte* Letter from Elridge A. Stafford, Director, Federal Relations, U S West, to Donna R. Searcy, Secretary, FCC, September 26, 1991.

[206]Bell Atlantic Comments at 5.

[207]*Ex Parte* Letter from Elridge A. Stafford, Director, Federal Relations, U S West, to Donna R. Searcy, Secretary, September 26, 1991.

[208]NYNEX Comments at 10; Bell Atlantic at 5.

[209]Our nonstructural safeguards benefit basic service ratepayers as well, relative to mandatory structural separation. As indicated, para. 48,

mandating the physical separation of assets and personnel used to provide enhanced services from those used to provide basic services, a structural separation requirement would eliminate all opportunity to realize the efficiencies and cost savings of integration. We do not agree with commenters who argue that other considerations would outweigh the benefits of integration. These commenters urge that any possible benefit of integration is outweighed by the relative ineffectiveness of nonstructural safeguards in protecting against cross-subsidization and discrimination. As detailed above, we find that the comprehensive set of nonstructural safeguards identified in this proceeding constitutes an effective regulatory alternative to structural separation for protecting against such abuses. Moreover, to the extent that nonstructural safeguards may involve any small diminution in protection against cost-subsidization and discrimination, we find that the danger of this is outweighed by the benefits of integration.

106. Similarly, we disagree with commenters who contend that heavier administrative burdens imposed by nonstructural safeguards require that we adopt a *Computer II* regime of structural separation. We have had several years' experience implementing cost accounting rules and other safeguards under *Computer III's* CEI regime for BOC provision of enhanced services. The resulting administrative burden does not lead us to conclude that use of nonstructural safeguards in the future will be an unacceptable administrative burden. Moveover, the future administrative burden of nonstructural safeguards may somewhat be reduced because it will not be necessary under ONA to

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supra, under our cost accounting rules, the BOCs must use a fully distributed costing methodology to allocate costs between enhanced and basic services. This means that some of the savings resulting from integrated provision of basic and enhanced services must contribute towards general overhead costs of the basic service operations. This would not be the case under structural separation.

approve use of nonstructural safeguards on an individual service basis, as under CEI. Further, structural separation imposes administrative burdens. Enforcement of structural separation, including review of affiliate transactions, requires significant administrative resources, as does evaluation of reasonably expected waiver requests. Thus, we do not find significant administrative advantages to structural separations.

107. We also conclude that we should not permit use of nonstructural safeguards only for particular enhanced services and/or permit only partial integration of some or all enhanced services. For example, some parties suggest that we should require the BOCs to offer enhanced services through a separate subsidiary generally, but permit joint activities whenever a BOC is able to demonstrate that it is more efficient or will result in benefits to the public. While it appears that some enhanced services may feasibility be provided using some form of a separate corporate subsidiary,[210] that does not persuade us to attempt to implement some modified structural separation requirement. Such an approach would involve case-by-case evaluation of enhanced service offerings, which would be cumbersome and time consuming and delay introduction of service offerings. Moreover, it would require us simultaneously to apply some form of separate subsidiary requirement for some services or carrier activities and nonstructural safeguards for other services or activities. This would not eliminate the administrative burden of either approach. Finally, we see little benefit to this approach since we do not find, contrary to this

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[210]Ameritech has chosen to provide enhanced services primarily through purchase of separate entities already providing enhanced services. Ameritech has elected not to integrate into the corporate parent. Ameritech Comments at 5-7. A decision not to integrate purchased, already freestanding, operational entities into existing carrier operations does not show that there are no efficiencies from integration.

approach's advocates, that there are substantial risks to nonstructural safeguards that make it desirable to remove structural separation only in narrow cases.[211]

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[211]Cox Cable and CompuServe contend that the proceedings at the Georgia Public Service Commission (Georgia PSC) regarding provision by BellSouth of voice mail service in the state, pursuant to an approved federal CEI plan, show that nonstructural safeguards are ineffective in preventing anticompetitive conduct. In the Matter of the Commission's Investigation into Southern Bell Telephone and Telegraph Company's Provision of Memory Call Service, Order of the Commission, Georgia Docket No. 4000-U (June 4, 1991). The Georgia PSC proceedings do not show that our safeguards are ineffective. The findings at the state level regarding unfair marketing and discrimination are based on "unhooking," as well as the failure of BellSouth to make available to competing voice mail providers physical collocation and certain basic features and functions desired by them until BellSouth decided to provide its own voice mail service. As is made clear in this *Report and Order*, unhooking is unacceptable under our nonstructural safeguards. *See* paragraph 89, *supra*. Our CEI/ONA requirements ensure that ESPs obtain "equal access" interconnection, absent mandatory collocation. Moreover, our CEI/ONA requirements reasonably preclude discriminatory provision of basic services required by ESPs. Under our interim CEI requirements, BellSouth must make available to independent ESPs the underlying basic network functions that BellSouth uses in providing its own enhanced services. Our permanent ONA requirements are more far reaching, and require an unbundling and availability of basic network functions irrespective of whether they are used in providing BOC enhanced services. Thus, in an ONA environment, BellSouth would violate our requirements if it unreasonably refused to make available, prior to offering its voice mail service, basic services desired by its voice mail competitors. Such an unreasonable refusal to offer a basic service is not justified because the service is not included in the BOC's approved ONA plan. Concerning the possibility of cross-subsidization, we have implemented cost accounting safeguards, including cost allocation standards, that define improper cross-subsidization. The Georgia PSC's finding of possible cross-subsidization at the state level is not sufficiently particularized at this time to permit evaluation of whether it may have any bearing on BellSouth's compliance with federal requirements.

108. In view of the foregoing, we conclude, contrary to our decision in *Computer II* and the *BOC Separation Order*, that based on a cost/benefit analysis, the record developed in this proceeding favors adoption of the nonstructural safeguards detailed above, rather than a structural separation requirement, to govern BOC participation in the enhanced services industry. We find that our strengthened nonstructural safeguards will permit the BOCs more fully to realize their potential in providing enhanced services to American consumers. We additionally find, in light of our determination that nonstructural safeguards will effectively protect against BOC cross-subsidization and discrimination, that a structural separation requirement is an unnecessary government intrusion into business judgments by the BOCs regarding the most effective corporate organization for the provision of enhanced services. A structural separation requirement for BOC provision of enhanced services would instead erect unnecessary barriers impeding the responsiveness of industry to marketplace incentives that foster increasing use and advancement of the nation's telecommunications assets. We therefore conclude to permit the BOCs to provide enhanced services pursuant to the nonstructural safeguards described in this *Report and Order* and once all conditions for lifting structural separation have been met. In the interim, the BOCs are allowed to file CEI plans and CEI waivers under the requirements set forth in *Computer III*.[212]

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[212]In the *BOC ONA Amended Plans Order*, we stated that structural separation requirements will be removed for each BOC when it files a notice informing us that: (1) it is technically prepared to offer each of its initial ONA services; (2) federal tariffs for each of its initial interstate ONA services are in effect; and (3) it has filed state tariffs for each of its initial intrastate ONA services (although such state tariffs do not have to be effective for the removal of structural separation). *BOC ONA Amended Plans Order*, 5 FCC Rcd at 3105, para. 13. The BOCs have filed their federal ONA tariffs. All of the BOCs, however, have re-

109. We are confident that, for the reasons cited, the benefits of nonstructural safeguards substantially outweigh any marginal costs. As technology and its applications evolve, the enhanced services marketplace will continue to develop. ONA, too, is an evolving process. We deem it prudent, therefore, for the Commission to review the nonstructural safeguards after the seven BOCs have operated

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quested waivers of the *Part 69/ONA* requirement that they tariff all basic service elements listed in their approved ONA plans. *See* Pleading Cycle Established For Comments on Bell Operating Company Petitions for Waiver of ONA Tariffing Orders, *Public Notice*, CC Docket Nos. 89-79, 88-2, DA 91-1424 (released November 15, 1991). We conclude that, in order to meet the requirements stated above for removal of structural separation, federal tariffs for all initial services listed in the BOCs' approved ONA plans must be effective, unless the Common Carrier Bureau grants waivers. The Common Carrier Bureau will place all BOC petitions for structural relief on public notice, and may seek additional information from the BOC, if necessary. Once thirty days have passed from the release of the public notice, and the Bureau is satisfied that the BOC has met the Commission's conditions for granting structural relief, the Bureau will issue an order or letter stating that structural separation requirements have been removed for the BOC. We also delegate to the Common Carrier Bureau the authority to oversee the process of removing structural separation requirements. In the interim period between the effective date of this Order and removal of structural separation, the BOCs may file CEI plans and CEI waivers. The BOCs are also permitted to provide enhanced services on an integrated basis pursuant to the *Computer II* waivers granted by the Commission following the *California* decision. The determinations in this *Report and Order* concerning removal of structural separation and adoption of nonstructural safeguards will became effective on February 1, 1992. On January 1, 1992, the BOCs may engage in integrated planning and development of enhanced services, once they have made any necessary amendments to their cost allocation manuals. *See e.g.*, Pacific and Nevada Bell Cost Allocation Plan for Enhanced Services Planning and Development, CC Docket No. 85-229, 2 FCC Rcd 1725 (1987).

under a full ONA environment for three years.[213] Such a review will enable the Commission to evaluate whether nonstructural safeguards have been effective in promoting a competitive enhanced services marketplace while permitting the BOCs to provide enhanced services more efficiently on an integrated basis, and whether any changes are necessary given our obligation to reevaluate regulations in light of changing conditions.

IV. *Preemption*

A. *Background*

110. In *Computer III,* the Commission preempted: (1) all state structural separation requirements applicable to the provision of enhanced services by AT&T, the BOCs, and the independents; (2) all state nonstructural safeguards applicable to AT&T and the BOCs inconsistent with federal safeguards; and (3) all state nonstructural safeguards applicable to the independents more stringent than those applied to AT&T and the BOCs.

111. In *California,* the Court vacated these preemption actions.[214] The Court was not persuaded that the Commission had adequately justified preemption of state structural separation requirements and of inconsistent nonstructural safeguards. The Court found that the Commission had failed to demonstrate that all state-imposed structural separation requirements would negate the federal interest in

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[213]For purposes of this review, a fully effective ONA environment will exist when all seven BOCs are no longer subject to the *Computer II* structural separation requirement.

[214]The *California* Court additionally found fault with the Commission's preemption in *Computer III* of state tariff regulation of intrastate enhanced services. In the *Notice,* note 96, we stated that we would not address in this proceeding preemption of state tariff regulation of intrastate enhanced services. Accordingly, we do not address that issue in this *Report and Order.*

permitting AT&T and the BOCs to offer integrated enhanced services. The Court stated that the Commission had made a plausible argument that some forms of state structural separation requirements — for instance, those that could require physical separation of intrastate basic and enhanced service facilities — could negate federal policies permitting structural integration. The Court found, however, that the Commission had failed to explain how the possibility that some forms of state structural separation requirements could negate federal policy had justified the Commission's preemption of all state structural separation requirements. The Court also stated that *Computer III* had failed to address the possibility that some enhanced services might be offered on a purely intrastate basis. The Court found as well that the Commission had failed to justify the breadth of the preemption of inconsistent state nonstructural safeguards applicable to AT&T and the BOCs. Finally, the Court found inadequate the Commission's explanation for preemption of state imposition on the independents of nonstructural safeguards more stringent than those imposed by the Commission on AT&T and the BOCs.[215]

112. In the *Notice* the Commission sought to examine preemption of state requirements for structural separation of various specific facilities and personnel functions,[216] and only a limited number of specific state nonstructural safeguards, including state network disclosure requirements that require initial disclosure at a time different from federal

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[215]*California,* 902 F.2d at 1244.

[216]The Commission specifically sought comment on the impact on federal policies of state requirements that AT&T, the BOCs, and independents provide enhanced services using structurally separate: (1) communications facilities and equipment, (2) computer facilities and software, (3) other facilities, such as real estate and vehicles, (4) general management, (5) operations, (6) marketing, (7) installation and maintenance, and (8) research and development.

rules and different state CPNI and nondiscrimination reporting requirements. The Commission sought comment on whether any preemption in these areas should apply to state requirements applicable to AT&T and the independents as well as to the BOCs.

B. *Comments*

1. *In General*

113. Of those parties commenting on preemption issues, most contend as a general matter that the Commission can and should preempt state safeguards that will thwart or impede federal objectives.[217] U S West, Pacific Bell, and SNET, by contrast, contend that the Commission should wait to assess the need to preempt until a state adopts or proposes conflicting requirements.[218] U S West argues that the Commission should not try to establish the nature of inseverability as a hypothetical matter, particularly when the nature of the service and the state regulation are unknown.[219] Pacific Bell urges that in this proceeding the Commission set forth guidelines for preemption of state safeguards. It contends that the Commission can and should preempt in the areas proposed in the Notice at the time a state establishes safeguards in those areas.[220]

114. A number of state public utility commissions oppose in general any preemption of possible state safeguard

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[217]NYNEX Comments at 63; SWBT Comments at 59; Ameritech Comments at 31; AT&T Comments at 3; IBM Comments at 13; API Comments at 5-6; GSA Comments at 3; NTIA Comments at 18; NTCA Comments at 2-3; SNET Comments at 16; USTA Comments at 20-21.

[218]U S West Comments at 110-111; Pacific Comments at 73; SNET Reply at 8-9.

[219]U S West Comments at 108-111; U S West Reply at 36-41.

[220]Pacific Bell Comments at 73-78.

requirements without commenting on the specific areas of preemption addressed in the *Notice*. The Washington UTC claims that our preemption proposals are flawed because they ignore the intrastate nature of some enhanced services, citing voice mail service. The Washington UTC and NARUC argue that, because of the interexchange restriction of the MFJ, the BOCs do not provide any interstate enhanced services, and thus there is no federal interest at stake warranting preemption.[221] The New York DPS and NARUC assert that the Commission has not shown that the proposed preemption is necessary to prevent states from thwarting achievement of federal objectives.[222] The California PUC, Florida PSC, and NARUC contend that there should not be uniform nationwide safeguards, but safeguards that take account of different intrastate market conditions.[223] The California PUC, Illinois Commerce Commission, and NARUC suggest that the Joint Conference should resolve the preemption issues in this proceeding.[224]

2. *Structural Separation*

115. Five of the BOCs, AT&T, and the independents support preemption of state structural separation require-

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[221]WUTC Comments at 16; NARUC Comments at 5. *See also* MCI Comments at 96-101.

[222]New York DPS Comments at 9-11; NARUC Comments at 5-8.

[223]California PUC Comments at 7; Florida PSC Comments at 5; NARUC Comments at 14-15.

[224]California Comments at 9; California Reply at 4-6; NARUC Comments at 12-14. The Federal-State Joint Conference on Open Network Architecture was established by the Commission in the *BOC ONA Order* in response to industry and state comments in the *ONA Proceeding* urging the Commission to establish a forum for continuing dialogue and cooperation between the Commission and the states. The Joint Conference serves as a forum to facilitate federal/state cooperation and the successful development and implementation of ONA.

ments. Ameritech, Bell Atlantic, BellSouth, NYNEX, and SWBT contend that it is not economically or practically possible for carriers to integrate provision of interstate enhanced services while simultaneously providing intrastate enhanced services pursuant to structural separation. [225] They claim that all of the facilities and personnel used to provide enhanced services are jointly used to provide interstate and intrastate enhanced services, and that there is no practical or economical way to permit simultaneously the integration of interstate enhanced services and the structurally separate provision of intrastate enhanced services.[226] Ameritech argues that the BOCs would necessarily have to comply with the most restrictive requirements because the complexities and loss of economies of scale resulting from overlapping organizations designed to provide identical offerings in different jurisdictions would more than exceed the cost of complying with the most restrictive rule.[227] AT&T, in comments limited to the preemption issue, also supports preemption of state structural separation requirements. It states that it has a single national unified network that provides both interstate and intrastate services that cannot as a practical matter be separated along jurisdictional lines.[228]

116. NTIA states that insofar as state and federal regulations require separation and integration of the same thing at the same time, the federal rule preempts the state one. It

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[225]Ameritech Comments at 30-31; Bell Atlantic Comments at 13; BellSouth Comments at 41-44; NYNEX Comments at 72; SWBT Comments at 63.

[226]Bell Atlantic Comments at 10-13; NYNEX Comments at 71; SWBT Comments at 63.

[227]Ameritech Comments at 30. *See also* Bell Atlantic Comments at 12; NYNEX Comments at 72; SWBT Comments at 62; Ameritech Comments at 30-31.

[228]AT&T Comments at 4-7; AT&T Reply at 6-9.

asserts that the FCC need not, and as a practical matter could not, analyze every possible safeguard a state may ever wish to impose.[229] Unisys, Integrated Communications Systems, Inc., and API support preemption of state structural separation requirements on the ground that it would make practically impossible the integrated offering of basic and interstate enhanced services. USTA, NTCA, GTE, SNET, Centel, and Cincinnati Bell support preemption of state structural separation requirements applied to independents for the same reasons advanced by the BOCs.[230]

117. Those states specifically commenting on this issue oppose preemption. The DC PSC, for example, states that the *Notice* failed to present any data demonstrating that any or all state structural separation requirements should be preempted. It states that the Commission has a very high burden under *California* to justify preemption. It claims that reorganization of personnel functions among corporate entities may not result in loss of efficiencies and, therefore, would not justify preemption.[231] The Florida PSC contends that, contrary to the *Notice's* assumption that there should be one nationwide solution for all services, states are in a better position to assess the need for structural separation.[232] Other states raise similar concerns.[233]

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[229]NTIA Comments at 19-20, 22.

[230]USTA Comments at 21; NTCA Comments at 3; GTE Comments at 3-4; SNET Comments at 16-17; Centel Comments at 12-14; Cincinnati Bell Comments at 8-9.

[231]DC PSC Reply at 16.

[232]Florida PSC Comments at 3.

[233]Vermont DPS Comments at 1; Pennsylvania Comments at 11; Hawaii Comments at 15-16.

3. *Customer Proprietary Network Information*

118. Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Bell, SWBT, and AT&T urge the Commission to preempt state CPNI rules that would require prior authorization.[234] They basically argue that any state prior authorization rule would effectively bar access for both interstate and intrastate services because it would be impossible to have a prior authorization rule for intrastate enhanced services while at the same time allowing access under the federal rule.[235] NYNEX and SWBT urge that the Commission review other state CPNI requirements on a case-by-case basis.[236] Integrated Communications Systems, API, and USTA also argue that CPNI cannot be separated by jurisdiction, and that the we should preempt different state rules.[237] NTCA states that the Commission should preempt state regulation of independents to the same extent that we preempt state regulation of the BOCs.[238] The DC PSC states that since the FCC agrees that the customer, if he elects to do so, may restrict access to his CPNI, it is not necessary for attainment of Commission goals to preempt states from determining that written customer authorization is to be required.[239]

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[234]Ameritech Comments at 31; Bell Atlantic Comments at 18; BellSouth Comments at 46-47; Pacific Bell Comments at 79; NYNEX Comments at 78-79; SWBT Comments at 66.

[235]NYNEX Comments at 78; Pacific Bell Comments at 80.

[236]NYNEX Comments at 79; SWBT Comments at 66.

[237]ICS Comments at 13; API Comments at 9; USTA Comments at 23.

[238]NTCA Reply at 2.

[239]DC PSC Comments at 40; DC PSC Reply at 16-17.

4. *Network Disclosure Rules*

119. A number of parties urge the Commission to preempt various state network disclosure rules. AT&T urges the Commission to preempt any state network disclosure rule that requires earlier or broader dissemination of information than is required by the federal rule. Information is inseverable by jurisdiction, AT&T argues, and broader dissemination would frustrate the federal goal of safeguarding carriers' legitimate proprietary interests and promoting innovation by, and competition among, basic service providers.[240] Ameritech, Pacific Bell, NYNEX, Integrated Communications Systems, and Cincinnati Bell agree with the reasoning in the *Notice* that state requirements for initial disclosure at times different from times specified in the federal rule would negate the federal rule.[241] SWBT states that theoretically a state could impose an advance notice period that differed slightly but would not negate either the purpose or the effect of the FCC rule.[242] Centel and NTCA urge the Commission to preempt state network disclosure requirements applicable to the independents to the same extent as the BOCs.[243]

120. The DC PSC contends that state network disclosure rules might not necessarily frustrate the ability of AT&T and the BOCs to provide integrated services. It asserts, however, that the Commission could preempt state requirements for initial disclosure after the make/buy point.[244]

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[240]AT&T Comments at 11-13. *See also* USTA Comments at 22.

[241]Ameritech Comments at 31; Pacific Bell Comments at 80; NYNEX Comments at 80; ICS Comments at 13; Cincinnati Bell Comments at 9-10. *See also* Bell Atlantic Comments at 13.

[242]SWBT Comments at 67-68.

[243]Centel Comments at 16; NTCA Comments at 5-6.

[244]DC PSC Comments at 39-40; DC PSC Reply at 16-17.

C. *Discussion*

121. In this *Report and Order*, we have determined that the public interest will be best served if the BOCs are permitted to use their substantial resources to serve customers and provide interstate enhanced services pursuant to a comprehensive set of nonstructural safeguards instead of a *Computer II* regime of structural separation. AT&T and the independents are already permitted to provide interstate enhanced services pursuant to nonstructural safeguards.[245] As stated in the *Notice*, it is inevitable that state commissions will have different experiences and perspectives that may lead them to adopt safeguards that are at variance with each other, and with federal safeguards. These differences should be accommodated whenever possible. Preemption of state regulation in this area should be as narrow as possible to accommodate differing state views while preserving federal goals. In this proceeding, we preempt state requirements for structural separation of facilities and personnel used to provide the intrastate portion of jurisdictionally mixed enhanced services, state CPNI rules requiring prior authorization that is not required by our rules, and state network disclosure rules that require initial disclosure at a time different than the federal rule. These state requirements would thwart or impede the nonstructural safeguards pursuant to which AT&T, the BOCs, and the independents

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[245]Nonstructural safeguards were reinstituted for AT&T's provision of enhanced services in Computer III Remand Proceeding, CC Docket No. 90-368, *Report and Order*, 5 FCC Rcd 7719 (1990). Independents have never been subject to structural separation for provision of enhanced services. All LECs other than average schedule companies are required to allocate costs between regulated and nonregulated activities in accordance with our cost allocation rules and policies. *Joint Cost Reconsideration Order*, 2 FCC Rcd at 6300, paras 154-159. Tier 1 LECs are subject to additional requirements, such as the requirement that they file cost allocation manuals. *Joint Cost Order*, 2 FCC Rcd at 1304, para. 47.

may provide interstate enhanced services and the federal goals that they are intended to achieve.[246] We do not preempt any other state safeguards, which we will review, if necessary, on a case-by-case basis.[247]

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[246]Contrary to the arguments of U S West and Pacific that we should wait for states to impose requirements that would thwart federal objectives before considering whether to preempt them, we are preempting the specific state safeguards discussed below, for which a sufficient record now exists. This approach will ensure that federal objectives are not thwarted while avoiding the procedural and practical difficulties that would be occasioned by carriers' obligations to comply with state requirements such as structural separation, pending review by this Commission of petitions to preempt. Further, our decision to preempt certain state safeguards is not based on "hypothetical" factors. States are taking steps to impose safeguards that would thwart federal objectives. For example, the DC PSC has recently proposed to require that the C&P Telephone Co. provide enhanced services pursuant to structural separation. Formal Case No. 904, In the Matter of the Investigation of Enhanced Services, *Notice of Proposed Rulemaking* (September 13, 1991). The Georgia PSC has indicated that it may require separate organizations for Southern Bell's provision of enhanced services in the state. Docket No. 3987-U, In Re Southern Bell T&T Co. Cross Subsidy, *Order* (October 1, 1991). The Texas PUC has proposed a prior authorization requirement. Project No. 9547, Telecommunications Privacy Issues, § 23.57, *Notice of Proposed Rulemaking* (October 18, 1991). Sufficient factual information has been submitted with respect to these and the other specific state safeguards identified below to warrant a finding of the practical impossibility of complying with these state safeguards while simultaneously integrating interstate basic and enhanced services. Extensive review with states and others has led the Commission to narrow significantly its approach to preemption here. In view of the demonstrated impact on federal objectives of the state actions we are preempting, a further reference to the Joint Conference is not necessary to establish a complete record to decide the issue.

[247] For instance, although the *Notice* sought comment on whether we need to preempt any state nondiscrimination reporting requirements, no commenter urged that we do so. We do not here consider the possible preemption of state regulatory requirements on grounds that they thwart or impede ONA safeguards other than the specific safeguards discussed here. The interrelationship of federal ONA, policies and state regulation

1. *State Structural Separation Requirements*

122. Under our comprehensive set of nonstructural safeguards, the BOCs will be able to offer interstate enhanced services on an integrated basis with interstate basic services, instead of a *Computer II* regime of structural separation. States may decide to require that intrastate enhanced services be provided on a structurally separate basis from intrastate basic services. The *Notice* proposed not to preempt a simple state requirement that a carrier establish a separate corporate entity for provision of intrastate enhanced services, but to preempt state requirements for separation of facilities and personnel that it tentatively concluded made it impossible as a practical matter for the BOCs to provide integrated interstate basic and enhanced services. We determine here that state structural separation requirements that apply to purely intrastate enhanced services, or that merely require a separate corporate entity with separate books of account for the intrastate portion of jurisdictionally mixed enhanced services, would not thwart federal objectives. However, we find that state requirements for separation of facilities and personnel used to provide the intrastate portion of jurisdictionally mixed enhanced services would thwart our objectives, and therefore preempt such requirements.

123. The Court in *California* found that the Commission had failed to justify the breadth of its preemption in *Computer III* because the *Computer III* opinion had failed to address the possibility that some enhanced services might be offered on a purely intrastate basis. Based on the record in this proceeding, we do not now think that applying state structural separation requirements to purely intrastate enhanced services would necessarily thwart our objectives for interstate enhanced services. Accordingly, we do not at this

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has been extensively considered in other proceedings. *See* Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Phase I, 4 FCC Rcd 1 (1988).

time preempt state structural separation requirements applicable to such services.

124. On the other hand, we believe that many, if not most, enhanced services provided by the BOCs, AT&T, and the independents are likely to be jurisdictionally mixed in nature. For such services, carriers could theoretically take two approaches to accommodating a state requirement for structural separation of facilities and personnel used to provide intrastate enhanced services while at the same time integrating interstate basic and enhanced services. First, in theory, carriers could establish a corporate entity with its own facilities and personnel that would be used to provide all enhanced services and interstate basic services on an integrated basis, and a separate corporate entity with its own facilities and personnel that would be used to provide intrastate basic services. This approach would involve separate facilities and personnel to provide interstate and intrastate basic services. As such, it would be wholly impractical and uneconomical. Many cases have recognized the impracticality of separate provision of interstate and intrastate basic communications.[248] This approach thus would not enable carriers to provide interstate enhanced services on an integrated basis while complying with state requirements to provide intrastate basic and enhanced services through structurally separate facilities and personnel.

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[248] *California v. FCC*, 905 F.2d at 1243, quoting NARUC v. FCC, 880 F.2d 422, 430 (D.C. Cir. 1989). *See also* Louisiana Public Service Commission v. FCC, 476 U.S. 355, 375 n. 4 (1986); North Carolina Utilities Commission v. FCC, 537 F.2d 787, 791 (4th Cir. 1976), *cert. denied*, 429 U.S. 1027, North Carolina Utilities Commission v. FCC 552 F.2d 1036 (4th Cir. 1977), *cert. denied*, 434 U.S. 874 (1973); Atlantic Richfield Co. v. FCC, 3 FCC Rcd 3089 (1988), *affirmed sub. nom.* Public Utility Commission of Texas v. FCC, 886 F.2d 1325 (D.C. Cir. 1989); *Illinois Bell Telephone Co. v. FCC*, 883 F.2d 104 (D.C.Cir. 1989).

125. Alternatively, the BOCs could seek to establish a corporate entity with its own facilities and personnel that would be used to provide intrastate enhanced services and essentially retain the facilities and personnel used to provide interstate enhanced services integrated with basic services, interstate and intrastate, within its existing corporate structure. This approach would require that carrier facilities and personnel used to provide the intrastate and interstate portions of an enhanced service be physically separate and duplicated — one set for intrastate enhanced services and one set for interstate enhanced services that would be integrated with interstate basic services.[249]

126. The record demonstrates, however, that this approach is no more operationally feasible than the first approach. As the BOCs assert, for example, it is not possible to market intrastate and interstate enhanced services separately, because customers do not want such services and because it would create great customer confusion to attempt to do so.[250] In addition, as is the case in trying to separate interstate and intrastate basic services, duplication of facilities used to provide interstate and intrastate enhanced ser-

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[249]We reject arguments of MCI and others that BOCs do not provide interstate enhanced services because of the interexchange restriction of the *MFJ*. IntraLATA services may be interstate either because the intraLATA service is transmitted by the BOC across state lines or because the service is part of a communication or service transmitted across state lines. It is well established that this Commission has jurisdiction over physically intrastate facilities and services used to provide interstate services. 47 C.F.R. § 153(a). New York Telephone Co. v. FCC, 631 F.2d 1059 (2nd Cir. 1980); Southern Pacific Communications, 61 FCC 2d 144 (1974).

[250]NYNEX Comments at 77, 74; BellSouth Comments at 42; SWBT Comments at 64. SWBT states that it has learned from market trials that there is very little market for enhanced services that would be limited to intrastate applications. *Id.* at 64. *See also Illinois Bell Telephone Co. v. FCC*, 883 F.2d 104 (D.C.Cir. 1989).

vices is not practically possible because of the many different facilities involved.[251] Separate general management and operations for the interstate and intrastate portions of a jurisdictionally mixed enhanced service also are not feasible because they would require extremely complex operating procedures for billing and collection, order taking, and service provisioning.[252] Separate installation and maintenance also are not practically possible because there would be great confusion, inefficiency, and difficulty involved in trying to have two corporations locate problems, which are likely to affect both the interstate and intrastate portions of the service.[253] Finally, it is not economically or technically feasible to perform separate research and development. Economically, the potential payback from such activity will be drastically reduced since each corporation will be able to apply the results only to its portion of the enhanced service, rather than the entire service.[254] Technically, implementing the results of separate interstate and intrastate research and development would require the same technical splintering of enhanced services that the courts have repeatedly affirmed as infeasible for basic services.[255] In sum, it is not feasible to perform these functions separately for intrastate and interstate portions of an enhanced service. The *Notice* specifically sought comment on whether we could more narrowly tailor our preemption to state structural separation requirements

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[251]NYNEX Comments at 72-73; BellSouth Comments at 43.

[252]NYNEX Comments at 74. For instance, a customer wishing to order both interstate and intrastate components of an enhanced service would have to order from two separate companies, and the provisioning of the service would require cumbersome technical and operational coordination by the two corporate entities. Training employees to perform this technical and operational coordination could be very complex.

[253]NYNEX Comments at 76; SWBT Comments at 63.

[254]SWBT Comments at 64.

[255]*See* note 248, *supra*.

affecting only specific types of facilities and personnel, but no party has suggested any feasible subset of facilities and personnel for preemption.

127. In addition, this second alternative is not feasible because the BOCs may not be able to identify the jurisdictional nature of the use of an enhanced service as it is being provided to the customer, which would be necessary for the BOC to ensure that it is being provided through the appropriate wholly separate corporation.[256] For example, the BOCs do not currently know the origin of any interLATA calls to the voice mail services they provide their customers.[257] Thus, it would be impossible to route an incoming call to different voice mail equipment based on jurisdiction. There is, in addition, no record support for the view that it is economically or practically possible to do so.[258] Accordingly,

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[256]Bell Atlantic Comments at 10-11; BellSouth Comments at 39-40; NYNEX Comments at 64-65; SWBT Comments at 63-64.

[257]No indication of the origin of a call is currently transmitted on interLATA calls except where Automatic Number Identification (ANI) is transmitted. ANI, which is the billing number of the caller, is transmitted from the originating LEC to the interexchange carrier for billing purposes. ANI is not, however, transmitted by the interexchange carrier to the terminating LEC. In any event, ANI provides a billing number, not the caller's telephone number, and therefore does not disclose the caller's location, The only circumstance under which the caller's telephone number is currently available to the terminating LEC is where a call is handled entirely by a single LEC that transmits the Calling Party Number via Signaling System 7 (SS7). Of course, depending on the technical configuration of any enhanced service, even that information might not be sufficient to determine the jurisdiction of an individual call.

[258]If a state imposed structural separation requirements, it would be necessary to know the jurisdiction of each call in order to assure that all intrastate calls were carried over separate facilities. In other contexts, for example, determining whether interstate or intrastate access charge rates apply, it is not necessary to know the jurisdiction of each call, but only to develop a reasonable surrogate for the jurisdictional split of the

we conclude that it is not practically possible for carriers to integrate the interstate enhanced service if the facilities and personnel of the intrastate enhanced service are subject to state structural separation requirements. As a practical matter state structural separation requirements will compel carriers to use structural separation for interstate services, and, therefore, will negate the federal policy for interstate enhanced services.

128. On the other hand, we are not now persuaded that a state requirement for merely a separate corporate entity with separate books of account for provision of the intrastate component of a jurisdictionally mixed enhanced service would thwart federal objectives. For example, we do not see that carrier personnel maintaining separate accounts for intrastate enhanced services would thwart the opportunity to integrate interstate enhanced services with basic service provision.

129. Because AT&T and the independents are permitted to provide interstate enhanced services on an integrated basis and our public interest objectives would be equally thwarted by state structural separation requirements applied to them, we equally preempt state structural separation requirements that require separate facilities and personnel for the intrastate portion of a jurisdictionally mixed enhanced service provided by AT&T and the independents. Similarly, we do not preempt requirements applicable to those carriers for a separate corporate entity with separate books of account for provision of the intrastate component of jurisdictionally mixed enhanced services.

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customer's traffic in aggregate. *See e.g.,* Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, Policy and Rules Concerning Rates for Dominant Carriers, CC Docket Nos. 89-79, 87-313, Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524 (1991), paras. 66-68.

2. *State CPNI Rules*

130. Under the CPNI rules we are adopting in this *Report and Order,* BOC personnel with involvement in marketing enhanced services will be able to access a customer's CPNI without prior written authorization, except for customers with more than twenty lines. AT&T and the independents' personnel involved in marketing enhanced services are not subject to any federal prior authorization requirements. Access to CPNI permits effective integrated marketing of enhanced services and permits the efficient use of carrier resources to provide enhanced services to a broad spectrum of customers. Personnel subject to a state prior authorization rule would not be able to access CPNI when it is permitted under the federal rule. Carrier implementation of a state prior authorization rule where it is not required under the federal rule would effectively require the separation of marketing and sales personnel dealing with interstate enhanced services from personnel dealing with interstate basic services. In these circumstances, the state rule effectively would negate federal policies in favor of achieving the efficiencies and associated public interest benefits of integrated marketing, such as the ability to serve the mass market. Contrary to the assertions of the DC PSC, the fact that a customer may restrict access to its CPNI does not prevent the thwarting of federal policy by state requirements that the carrier obtain prior authorization. Accordingly, we preempt state CPNI rules applicable to the BOCs, AT&T, and independents that require prior authorization whenever such authorization is not required by our rules. Because we are not persuaded at the same time that other aspects of state CPNI rules would thwart or impede federal objectives, we are not preempting such state rules in this proceeding.

3. *State Network Disclosure Rules*

131. Under our network disclosure rules, initial disclosure of network information affecting the interconnection of enhanced service providers is generally required at the make/buy point, *i.e.,* when the carrier decides to make itself, or to procure from an affiliated entity, any product the design of which relies on the network interface. The timing of this disclosure seeks to strike a balance between assuring that independent ESPs receive network information on a timely basis and preventing premature disclosure that could impair carriers' service development efforts and inhibit network innovation. A state rule that required timing of initial disclosure at a time that differs from the federal rule would substitute a state balancing for the federal balancing of these concerns, and could injure company development and network innovation efforts. While, as suggested by SWBT, states could adopt timing requirements that differed only slightly from the federal rule, carriers cannot simultaneously comply with differing state and federal requirements for initial disclosure of network information given that initial disclosure can occur only once. As stated in the *Notice,* a state rule that required initial disclosure at a time that differs from the time specified in the federal rule would negate the federal timing because by definition, initial disclosure can occur only once. Accordingly, we preempt state network disclosure rules that require initial disclosure at a time different than the federal rule. We are not persuaded at this time that any state rule that required disclosure of different or broader information would necessarily thwart federal network disclosure rules, and therefore will consider any problems that may arise on a case-by-case basis with other aspects of state network disclosure rules. We additionally do not preempt state network disclosure rules applicable to carriers that are not subject to the federal network disclosure rule.

V. *Ordering Clauses*

132. Accordingly, IT IS ORDERED, that pursuant to authority contained in Sections 1, 4, 201-205, 218, and 220 of the Communications Act of 1934, as amended, 47 U.S.C. Sections 151, 154, 201-205, 218, and 220, Part 64 is AMENDED as set forth in Appendix B.

133. IT IS FURTHER ORDERED, that the policies, rules, and requirements set forth herein ARE ADOPTED.

134. IT IS FURTHER ORDERED, that the Chief, Common Carrier Bureau is delegated authority to act upon matters pertaining to implementation of the policies, rules, and requirements as set forth herein.

135. IT IS FURTHER ORDERED that the decisions in this *Report and Order* concerning removal of structural separation and adoption of nonstructural safeguards including the amendments to Part 64 SHALL BE EFFECTIVE February 1, 1992.[259]

136. IT IS FURTHER ORDERED, that the elimination of the capitalization plan requirement, the prohibition against the regulated BOC company and its affiliates from performing software development for one another, and the

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[259]We order an effective date of February 1, 1992, in order to permit the timely filing of petitions for structural relief by the BOCs on or about February 1, 1992, when federal ONA tariffs are scheduled to become effective. Petitions for structural relief could not be filed on that date unless our establishment herein, see footnote 212, *supra*, of the procedures and preconditions for filing such petitions were effective prior to that date. Accordingly, we find good cause that the effective date should be less than 30 days from publication in the Federal Register. *See* Section 553 (d)(3) of the Administrative Procedure Act, 5 U.S.C. § 553 (d)(3).

prohibition against integrated planning and development IS EFFECTIVE January 1, 1992.[260]

137. IT IS FURTHER ORDERED, that the preemption decisions adopted herein SHALL BE EFFECTIVE thirty days after publication of this Report and Order in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION

Donna R. Searcy
Secretary

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[260]The publication of a substantive rule which relieves a restriction may be made less than thirty days before its effective date. *See* Section 553 (d)(1) of the Administrative Procedure Act, 5 U.S.C. § 553 (d)(1). Our decision to remove the capitalization plan requirement, the prohibition against the regulated BOC company and its affiliates performing software development for one another, and the prohibition against integrated planning and development falls within that provision.

APPENDIX A

BOC SAFEGUARDS COMMENTS
CC Docket No. 90-623

AccessPlus Communications, Inc. (AccessPlus)

ADAPSO, The Computer Software and Services Industry Association, Inc. (ADAPSO)

Ad Hoc Telecommunications Users Committee (Ad Hoc)

Alarm Industry Communications Committee (AICC)

American Institute of Certified Public Accountants (AICPA)

American Newspaper Publishers Association (ANPA)

American Petroleum Institute (API)

American Public Communications Council (APCC)

American Telephone & Telegraph Company (AT&T)

Ameritech Operating Companies (Ameritech)

Arkansas Public Service Commission; Kansas Corporation Commission; Missouri Public Service Commission; Oklahoma Corporation Commission; Public Utility Commission of Texas on behalf of the Southwest Regional Regulatory Group (SW Group)

Association of American Railroads (AAR)

Association of Telemessaging Services International, Inc. (ATSI)

Bell Atlantic Telephone Companies (Bell Atlantic)

BellSouth Corporation, South Central Bell Telephone Company, and Southern Bell Telephone and Telegraph Company (BellSouth)

California Public Utilities Commission and People of the State of California (California)

California Bankers Clearinghouse Association, New York Clearing House Association, Mastercard International Incorporated, and VISA U.S.A., Inc. (ONA Users Group)

Central Telephone Company (Central)

Cincinnati Bell Telephone (CBT)

Citizens for a Sound Economy Foundation (CSEF)

Colorado Public Utilities Commission (Colorado PUC)

CompuServe Incorporated (CompuServe)

Computer and Business Equipment Manufacturers Association (CBEMA)

Department of Justice (DOJ)

District of Columbia Public Service Commission (DC PSC)

Dun & Bradstreet Corporation (Dun & Bradstreet)

Florida Public Service Commission (Florida PSC)

General Services Administration (GSA)

GTE Service Corporation and affiliated companies (GTE)

State of Hawaii

Illinois Commerce Commission (Illinois Commission)

Independent Data Communications Manufacturers Association (IDCMA)

Independent Telecommunications Network, Inc. (ITN)

Information Industry Association (IIA)

Integrated Communication Systems, Inc. (ICS)

International Business Machines Corporation (IBM)

International Communications Association (ICA)

Iowa Network Services, Inc. (INS)

MCI Telecommunications Corporation (MCI)

MessagePhone, Inc. (MessagePhone)

Michigan Public Service Commission (Michigan PSC)

National Association of Broadcasters (NAB)

National Association of Regulatory Utility Commissioners (NARUC)

National Telecommunications and Information Administration (NTIA)

National Telephone Cooperative Association (NTCA)

New York Department of Public Service (NY DPS)

NYNEX Telephone Companies (NYNEX)

Oregon Public Utility Commission (Oregon PUC)

Pacific Bell and Nevada Bell (PacTel)

Pennsylvania Office of Consumer Advocate (Pennsylvania)

Rochester Telephone Corporation (Rochester)

Southern New England Telephone Company (SNET)

Southwestern Bell Telephone Company (SWBT)

Stroh Ranch Communications Limited Partnership (Stroh Ranch)

Tele-communications Association (TCA)

Unisys Corporation (Unisys)

United States Telephone Association (USTA)

US Sprint Communications Company Limited Partnership (US Sprint)

US West Communications, Inc. (US West)

Utilities Telecommunications Council (UTC)

Vermont Department of Public Service (Vermont DPS)

Washington Utilities and Transportation Commission (Washington UTC)

BOC SAFEGUARDS REPLY COMMENTS
CC Docket No. 90-623

ADAPSO, The Computer Software and Services Industry Association, Inc. (ADAPSO)

Ad Hoc Telecommunications Users Committee (Ad Hoc)

American Newspaper Publishers Association (ANPA)

American Telephone & Telegraph Company (AT&T)

Ameritech Operating Companies (Ameritech)

Association of Telemessaging Services International, Inc. (ATSI)

Bell Atlantic Telephone Companies (Bell Atlantic)

BellSouth Corporation, South Central Bell Telephone Company, and Southern Bell Telephone and Telegraph Company (BellSouth)

California Public Utilities Commission and People of the State of California (California)

California Bankers Clearinghouse Association, New York Clearing House Association, Mastercard International Incorporated, and VISA U.S.A., Inc. (ONA Users Group)

CompuServe Incorporated (CompuServe)

District of Columbia Public Service Commission (DC PSC)

General Services Administration (GSA)

GTE Service Corporation and affiliated companies (GTE)

State of Hawaii

Independent Data Communications Manufacturers Association (IDCMA)

Information Industry Association (IIA)

Integrated Communication Systems, Inc. (ICS)

McGraw-Hill, Inc. (McGraw-Hill)

National Cable Television Association, Inc. (NCTA)

National Telephone Cooperative Association (NTCA)

NYNEX Telephone Companies (NYNEX)

Oregon Public Utility Commission (Oregon PUC)

Pacific Bell and Nevada Bell (Pacific)

Southern New England Telephone Company (SNET)

Southwestern Bell Telephone Company (SWBT)

Tele-communications Association (TCA)

Texas Public Utilities Commission (Texas PUC)

United States Telephone Association (USTA)

US Sprint Communications Company Limited Partnership (US Sprint)

US West Communications, Inc. (U S West)

APPENDIX B

Amendments to the Code of Federal Regulations

Title 47 of the C.F.R., Part 64, is amended as follows:

Part 64 — Miscellaneous Rules Relating to Common Carriers

1. The authority citation for Part 64 continues to read as follows:

Authority: Sec. 4, 48 Stat. 1066, as amended; 47 U.S.C. 154. Interpret or apply secs. 201, 218, 48 Stat. 1070, as amended, 1077; 47 U.S.C. 201, 218.

2. New section 64.903 is added to read as follows:

64.903 Cost Allocation Manuals

(a) Each local exchange carrier with annual operating revenues of $100 million or more shall file with the Commission a manual containing the following information regarding its allocation of costs between regulated and nonregulated activities:

(i) A description of each of the carrier's nonregulated activities;

(ii) A list of all the activities to which the carrier now accords incidental accounting treatment and the justification therefor;

(iii) A chart showing all of the carrier's corporate affiliates;

(iv) A statement identifying each affiliate that engages in or will engage in transactions with the carrier and describing the nature, terms and frequency of each transaction;

(v) A cost apportionment table showing, for each account containing costs incurred in providing regu-

lated services, the cost pools within that account, the procedures used to place costs into each cost pool, and the method used to apportion the costs within each cost pool between regulated and nonregulated activities; and

(vi) A description of the time reporting procedures that the carrier uses, including the methods or studies designed to measure and allocate non-productive time.

(b) Each carrier shall ensure that the information contained in its cost allocation manual is accurate. Carriers must update their manuals at least quarterly, except that changes to the cost apportionment table and to the description of time reporting procedures must be filed at least 60 days before the carrier plans to implement the changes. Proposed changes in the description of time reporting procedures, the statement concerning affiliate transactions, and the cost apportionment table must be accompanied by a statement quantifying the impact of each change on regulated operations. Changes in the description of time reporting procedures and the statement concerning affiliate transactions must be quantified in $100,000 increments at the account level. Changes in cost apportionment tables must be quantified in $100,000 increments at the cost pool level. The Chief, Common Carrier Bureau may suspend any such changes for a period not to exceed 180 days, and may thereafter allow the change to become effective or to prescribe a different procedure.

(c) The Commission may by order require any other communications common carrier to file and maintain a cost allocation manual as provided in this section.

(3) New section 64.904 is added to read as follows:

64.904 Independent Audits

(a) Each local exchange carrier required by this Part or by Commission order to file a cost allocation manual shall have performed annually, by an independent auditor, an audit that provides a positive opinion on whether the applicable data shown in the carrier's annual report required by Section 43.21(f)(2) of this Chapter presents fairly, in all material respects, the information of the carrier required to be set forth therein in accordance with the carrier's cost allocation manual, the Commission's Joint Cost Orders issued in conjunction with CC Docket No. 86-111 and the Commission's rules and regulations including Sections 32.23, 32.27, 64.901 and 64.903 in force as of the date of the auditor's report. The audit shall be conducted in accordance with generally accepted auditing standards, except as otherwise directed by the Chief, Common Carrier Bureau.

(b) The report of the independent auditor shall be filed at the time that the local exchange carrier files the annual report required by Section 43.21(f)(2) of this Chapter.

November 21, 1991

SEPARATE STATEMENT OF COMMISSIONER ERVIN S. DUGGAN

In Re: **Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards**

I have decided, after carefully weighing the arguments favoring nonstructural safeguards — and despite lingering concerns about the adequacy of such safeguards — to join my fellow Commissioners in voting to rely on nonstructural safeguards for Bell Operating Company provision of enhanced services.

I am persuaded that allowing the Bell Operating Companies to provide enhanced services on an integrated basis does promise significant public interest benefits. Those benefits are sufficient, in my mind, to outweigh the costs of forgoing the protections of structural separation. Integrated operations generate cost savings that if passed on to the consumer could provide real public benefits. In particular, it appears that the cost savings derived from joint marketing of enhanced and basic services may mean that the BOCs can provide affordable enhanced services to the mass market that others may not be able to provide profitably. Voice messaging is an obvious example.

We are heading, nevertheless, into uncharted territory. The MFJ restriction has only recently been lifted. As technology and its applications evolve, the enhanced services marketplace will develop in ways that are not easy to predict. Open Network Architecture, too, is an evolving process; we do not yet have experience with federally tariffed ONA services.

So in the end, my decision to support this item rests upon one important feature: a pledge by the Commission, in-

cluded in the order we adopt today, to review the effectiveness of nonstructural safeguards after three years. We will determine in that three-year review proceeding whether our nonstructural safeguards have in fact been effective in protecting against discrimination and cross-subsidies. If we find after three years' experience that nonstructural safeguards have not succeeded, then I presume we will not hesitate to reimpose whatever structural separation requirements appear necessary.

It seems to me essential for travelers heading off into uncharted territory to take along safety equipment and to devise ways to retrace their steps if they take a wrong turn. The three-year review proceeding offers both. It will give us a chance to test empirically the Commission's predictions about the efficacy of our safeguards and the public interest benefits of integration. And it gives us at least some chance to correct any mistakes we might find that the Commission has made in its enthusiasm for nonstructural safeguards.

APPENDIX C

47 U.S.C. § 151:

For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is created a commission to be known as the "Federal Communications Commission", which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this chapter.

(June 19, 1934, c. 652, Title I, § 1, 48 Stat. 1064; May 20, 1937, c. 229, § 1, 50 Stat. 189.)

47 U.S.C. § 152(b):

Except as provided in sections 223 or 224 and 225 of this title and subject to the provisions of section 301 of this title and subchapter V-A of this chapter, nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (3) any carrier en-

gaged in interstate or foreign communication solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (4) any carrier to which clause (2) or clause (3) of this subsection would be applicable except for furnishing interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico; except that sections 201 to 205 of this title shall, except as otherwise provided therein, apply to carriers described in clauses (2), (3) and (4) of this subsection.

(June 19, 1934, c. 652, Title I, § 2, 48 Stat. 1064; 1946 Proc. No. 2695, eff. July 4, 1946, 11 F.R. 7517, 60 Stat. 1352; Apr. 27, 1954, c. 175, § 1, 68 Stat. 63; Feb. 21, 1978, Pub.L. 95-234, § 5, 92 Stat. 35; Oct. 30, 1984, Pub.L. 98-549, § 3(a), 98 Stat. 2801; Nov. 21, 1989, Pub.L. 101-166, Title V, § 521(2), 103 Stat. 1193; July 26, 1990, Pub.L. 101-336, Title IV, § 401(b)(1), 104 Stat. 369.)

Nos. 94-1173 and 94-1213

Supreme Court, U.S.
FILED
MAR 13 1995
OFFICE OF THE CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

STATE OF NEW YORK, *et al.*,
Petitioners,

MARYLAND PEOPLE'S COUNSEL, *et al.*,
Petitioners-Intervenors,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents,

VOICE-TEL ENTERPRISES, INC., *et al.*,
Respondents-Intervenors.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF IN OPPOSITION FOR RESPONDENTS-INTERVENORS

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QUESTION PRESENTED

Whether the Federal Communications Commission may preempt state regulations to the degree necessary to keep such regulations from negating the Commission's exercise of its lawful authority over interstate communication services.

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Respondents-Intervenors.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

---

BRIEF IN OPPOSITION FOR RESPONDENTS-INTERVENORS

The decision below is correct, and there is no conflict with any decision of this Court or of any other Court of Appeals. Accordingly, the petitions for a writ of certiorari should be denied.

STATEMENT

Since 1971, in a series of decisions known as the "Computer Inquiries," the Federal Communications Commission ("FCC" or "Commission") has been wrestling with the proper treatment of the intersection between telephones and computers. In 1980, the Commission decided to deregulate all computer-enhanced services,[1] but to permit AT&T—and later, the divested Bell Operating Companies ("BOCs")—to provide such services only through separate subsidiaries (with separate facilities, personnel, accounts, and corporate identity).[2] The Commission was concerned that AT&T, because it had a regulated monopoly over the means of transmitting enhanced services, would otherwise be in a position to dominate the provision of such services by discriminating against competing providers or by cross-subsidizing its own services (*i.e.*, shifting costs from the unregulated, enhanced services to the regulated, basic services).

In 1986, the Commission became concerned that this regime of strict structural separation was impeding the

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[1] Enhanced services combine communications transmission with computer processing applications that act on the format or content of transmitted information; provide subscribers with additional, different or restructured information; or allow subscriber interaction with stored data. *See* 47 C.F.R. § 64.702(a). Examples of enhanced services are voice mail, remote data processing, and interactive databases (such as on-line legal research services).

[2] Final Decision, *Amendment of Section 64.702 of the Commission's Rules & Regulations (Second Computer Inquiry)*, 77 F.C.C.2d 384 *("Computer II"), modified on recon.*, 84 F.C.C.2d 50 (1980), *further modified on recon.*, 88 F.C.C.2d 512 (1981), *aff'd sub nom. Computer & Communications Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983), *aff'd on second further recon.*, FCC 84-190 (released May 4, 1984).

development not only of a vibrant interstate enhanced services marketplace but also of a more modern interstate telecommunications network. In its *Computer III* order, the Commission decided to replace structural separation with nonstructural safeguards that would protect ratepayers and competitors against any forms of discrimination or cross-subsidy while permitting the efficiency of structural integration. Report and Order, *Amendment of Section 64.702 of the Commission's Rules & Regulations (Third Computer Inquiry)*, 104 F.C.C.2d 958, 1002 (1986) ("*Phase I Order*"), *modified on recon.*, 2 FCC Rcd 3035 (1987), *further modified on recon.*, 3 FCC Rcd 1135 (1988). At the same time, the Commission sought to preempt any state regulation of enhanced services. *Phase I Order*, 104 F.C.C.2d at 1125-26. In particular, the Commission sought to bar states from imposing structural separation requirements on telephone carriers. Report and Order, *Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, 2 FCC Rcd 3072, 3102 (1987).

In 1990, a divided panel of the Ninth Circuit vacated the *Computer III* orders and remanded the entire proceeding to the Commission. *See California v. FCC*, 905 F.2d 1217 (9th Cir. 1990). The Court concluded that the FCC had failed sufficiently to explain how certain nonstructural safeguards would guard against cross-subsidization by the BOCs. The Court also found that the FCC's preemption order was overbroad. "The FCC may not justify a preemption order," the Court stated, "merely by showing that *some* of the preempted state regulation would, if not preempted, frustrate FCC regulatory goals. Rather, the FCC bears the burden of justifying its *entire* preemption order by demonstrating that the order is narrowly tailored to preempt *only* such state regulations as would negate valid FCC regulatory goals." *Id.* at 1242-43. Some enhanced services might be offered on a purely intrastate basis, the Court noted, and the FCC had not explained how structural separation of such

purely *intra*state enhanced services would interfere with a carrier's provision of *inter*state enhanced services. *Id.* at 1244.

In its 1991 *Computer III Remand Order*, Pet. App. A34-A154, the Commission reaffirmed its elimination of structural separation, but adopted a much narrower, and more carefully crafted preemption order. The states may order structural separation for "purely intrastate enhanced services," and may also require "a separate corporate entity with separate books of account for the intrastate portion of jurisdictionally mixed enhanced services." *Id.* at A134. But the states may not require separate facilities and personnel for "the intrastate portion of jurisdictionally mixed enhanced services" because such requirements would necessarily entail separation of facilities and personnel used to provide interstate services as well. "As a practical matter," the Commission explained, "state structural separation requirements will compel carriers to use structural separation for interstate services, and, therefore, will negate the federal policy [of permitting structural integration] for interstate enhanced services." *Id.* at A139.[3]

On appeal, the Ninth Circuit again remanded, for further explanation, the Commission's decision to eliminate structural separation for interstate enhanced services. *Id.* at A1-A33. The court upheld the preemption order, however. "The FCC has presented adequate record support," the court noted, for its conclusion that "it would not be economically or operationally feasible" for the BOCs to offer the interstate portion of jurisdictionally mixed services on an integrated basis "while maintaining separate facilities and personnel for the intrastate portion." *Id.* at A31-A32. As a consequence, if such state regulations were allowed to stand, "enhanced service providers would

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[3] The Commission also preempted contrary state rules dealing with the use of customer information and the disclosure of network changes. *See* Pet. App. A140-A142.

separate their facilities for services that are offered both interstate and intrastate, thereby essentially negating the FCC's goal of allowing integrated provision of enhanced and basic services." *Id.* at A31. Under these circumstances, the Court concluded, where federal and state regulations cannot coexist, the state regulations must give way. *Id.* at A31 (citing *Louisiana Public Service Commission v. FCC*, 476 U.S. 355, 375 n.4 (1986)).

On remand, the FCC issued a new Notice of Proposed Rulemaking, *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services*, FCC No. 95-48, CC Dkt. No. 95-20 (released Feb. 21, 1995), in which it proposed to review the various nonstructural safeguards against BOC access discrimination currently in place and to determine, more generally, "whether structural separation should be reimposed for some or all BOC enhanced services." *Id.* at 3.

ARGUMENT

The decision below involves a straightforward application of *Louisiana Public Service Commission v. FCC*, *supra*. In that case, the court drew a distinction between FCC regulations that tread unnecessarily upon the authority of the states to regulate purely intrastate communications and FCC action that preempts state regulations in circumstances "where it [i]s not possible to separate the interstate and the intrastate components of the asserted FCC regulation." 476 U.S. at 375 & n.4.

Here, the FCC concluded, and the court below agreed, that it is not possible to separate the interstate and the intrastate components of some aspects of the FCC's regulations governing the BOCs' enhanced services offerings. *See* Pet. App. A139, A31. Petitioners do not suggest that this Court should review that fact-bound determination. Nor do they challenge the FCC's general statutory authority to regulate the terms and conditions under which the BOCs may provide interstate enhanced services.

Petitioners' sole contention is that, where otherwise valid federal regulations of interstate communications cannot coexist with state regulations of intrastate communications, the federal regulations must give way unless the FCC is performing "an express statutory duty," such as setting tariffs, pursuant to Title II of the Communications Act.[4] New York Pet. 20. *See also* Cal. Pet. 12. Specifically, petitioners contend that FCC regulations passed pursuant to its general, Title I responsibilities[5] must give way before inconsistent state regulations because 47 U.S.C. § 152(b) reserves to the states authority to promulgate "regulations for or in connection with intrastate communication service by wire or radio of any carrier." That position—which amounts to inverse preemption of federal regulations by the states—is untenable.[6]

1. As this Court has recognized, Title I empowers the agency to take "all regulatory actions 'necessary to ensure achievement of [its] statutory responsibilities.' " *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 700 (1984) (quoting *FCC v. Midwest Video Corp.*, 440 U.S. 689, 706 (1979)). Among these are the responsibilities to "make available, so far as possible, to all the people of the United States, a rapid, efficient nationwide and world-

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[4] Title II of the Act, 47 U.S.C. § 201 *et seq.*, authorizes the FCC to impose entry, exit, and tariff regulation on services (such as basic voice telephony) that are provided on a common carrier (as opposed to a private carriage) basis.

[5] Title I of the Act—which "confer[s] regulatory authority over 'all interstate . . . communication by wire or radio,' " *United States v. Southwestern Cable Co.*, 392 U.S. 157, 173 (1968) (quoting 47 U.S.C. § 152)—gives the FCC jurisdiction over "those activities and forms of communication that are [not] specifically described by the Act's other provisions," such as Title II. *Id.* at 172.

[6] Even the initial premise of petitioners' argument is faulty since, in passing the regulations at issue here, the FCC was acting pursuant to *both* its Title I and its Title II authority. *See* Pet. App. A142.

wide communications service with adequate facilities at reasonable rates" and to "encourage the provision of new services and technologies to the public." 47 U.S.C. §§ 151, 157.

The Communications Act does not expressly discuss the affirmative scope of the FCC's preemption power. But this Court has held that where the FCC adopts a valid policy within its statutory authority—including its Title I authority—it has plenary power under the Supremacy Clause to "determine that its authority is exclusive" and to preempt "any state efforts to regulate in the forbidden area." *City of New York v. FCC*, 486 U.S. 57, 64 (1988); *see also Capital Cities Cable, Inc. v. Crisp*, 467 U.S. at 698-700 (upholding FCC preemption, under Title I, of "any state regulation of the signals carried by cable system operators"); *United States v. Southwestern Cable Co.*, 392 U.S. 157 (1986) (upholding FCC preemption under Title III). Preemption power thus is an adjunct to any lawful exercise of the FCC's authority; it does not matter which title or titles of the Act create the responsibility being discharged by the agency.

2. Section 152(b), in carving out an area of state jurisdiction, makes no distinction between Title I regulation and Title II regulation. Section 152(b) states that "nothing in *this chapter*" gives the Commission jurisdiction over "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier." The words "this chapter" refer to Chapter 5 and embrace both subchapter I (Title I) and subchapter II (Title II) of Chapter 5. Both the general mandates of Title I and the more specific mandates of Title II, therefore, must be construed in light of Section 152(b).

That is precisely how the Court proceeded in *Louisiana*. Although 47 U.S.C. § 220, a Title II provi-

sion, granted the FCC explicit regulatory authority over depreciation, the Court concluded that that authority must be exercised consistent with Section 152(b)'s reservation of authority to the states. Thus, Section 220 did not grant the FCC authority to override state depreciation schedules for intrastate telephone facilities. 476 U.S. at 376-77.

The Court applied the same analysis to the more general mandate of Section 151, in Title I. The FCC had concluded that accelerated depreciation schedules would best serve its goal of modernizing the nation's communications system. But since it was possible—through what is known as the "jurisdictional separations" process—to have one set of rates for the depreciation of interstate plant and another set of rates for the depreciation of intrastate plant, the FCC was restricted by Section 152(b) to setting the rates for interstate plant. *Louisiana*, 476 U.S. at 375-76. "Because the separations process literally separates costs such as taxes and operating expenses between interstate and intrastate service," the Court explained, "it facilitates the creation or recognition of distinct spheres of regulation." *Id.* at 375. "[O]nce the correct allocation between interstate and intrastate use has been made," the Court concluded, "it is certainly possible to apply different rates and methods of depreciation." *Ibid.*

In a critical footnote, the Court then stated that the depreciation issue was "readily distinguishable from those [cases] in which FCC pre-emption of state regulation was upheld where it was *not* possible to separate the interstate and the intrastate components of the asserted FCC regulation." *Id.* at 375 n.4 (citing *North Carolina Utils. Comm'n v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976) (*"NCUC I"*); *North Carolina Utils. Comm'n v. FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) (*"NCUC*

II")).[7] Where it is "*not* possible to separate the interstate and the intrastate components of the asserted FCC regulation," 476 U.S. at 375 n.4, the inconsistent state regulations must fall under the general principle that "a federal agency acting within the scope of its congressionally delegated authority may preempt state regulation." *Id.* at 369.[8]

Contrary to petitioners' assertion, therefore, the Court in *Louisiana* did not reject the FCC's Title I preemption authority. Rather, the Court made a careful analysis of the specific preemption order at issue. Because the Court concluded that it was feasible to have separate intrastate and interstate depreciation rates, it overturned the FCC's preemption order. But the clear implication of the decision is that, if such separation had not been possible, the preemption order would have been sustained.

3. The decision below carefully follows the distinction made in *Louisiana*. As the Ninth Circuit explained, "the only limitation on a state's authority over intrastate telephone service is 'when the state's exercise of that authority negates the exercise by the FCC of its own lawful authority over interstate communication.'" Pet.

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[7] In *NCUC I* and *NCUC II*, the Fourth Circuit upheld an FCC order preempting states from adopting regulations that barred connection of noncarrier-provided customer premises equipment (such as a telephone handset) to the telephone network for use in intrastate communications. Because the same telephone is used for intrastate and interstate calls, a state decision to forbid the interconnection of non-telco-supplied equipment would necessarily negate the federal decision to permit it. In that circumstance, the Court of Appeals concluded, the contrary state regulations must give way. *See* 537 F.2d at 791-92.

[8] Petitioners claim that the "impossibility" exception established in footnote 4 of *Louisiana* applies only to Title II regulations, not to Title I's more general mandates. But footnote 4 is placed in a section discussing Title I, not Title II, and there is no reason—either in the opinion itself or in the general law of preemption—to believe this Court intended to limit its reach.

App. A29 (citing *California I* at 1243). The court stressed that this "impossibility exception is narrow, and that the FCC has the burden of showing that the state regulation would negate valid FCC regulatory goals." *Id.* at A29. The court below properly concluded that the FCC had met that burden here.

As the Commission itself explained, its preemption order is "as narrow as possible to accommodate differing state views while preserving federal goals." *Id.* at A132. The order permits states to apply "state structural separation requirements that apply to purely intrastate enhanced services, or that merely require a separate corporate entity with separate books of account for the intrastate portion of jurisdictionally mixed enhanced services." *Id.* at A134. But it draws the line at "state requirements for separation of facilities and personnel used to provide the intrastate portion of jurisdictionally mixed enhanced services" because such requirements would necessarily entail separation of facilities and personnel used to provide interstate services as well. *Ibid.* The Court of Appeals agreed. *See Id.* at A31 ("The FCC has presented adequate record support for its conclusion that because of economic and operational factors, enhanced service providers would separate their facilities for services that are offered both interstate and intrastate, thereby essentially negating the FCC's goal of allowing integrated provision of enhanced and basic services.") Under these circumstances, where federal and state regulations cannot coexist, the state regulations must give way.

4. Contrary to the claims of the State of California (Pet. 12-17), there is no split among the circuits on the question of the nature or extent of the FCC's preemptive authority under Title I. The decision below expressly follows, and is fully consistent with the decision of the Fourth Circuit in *NCUC I* and *NCUC II*. *See* n.7, *supra*. California mischaracterizes these cases by claiming that the states themselves were responsible for creating the

conflict with federal regulations by refusing to order separate telephones for intrastate calls. If the state had chosen "to force . . . customers to have two telephones, one for interstate use and one for intrastate use," California argues, "then it would not have been impossible for customers to comply with both federal and state regulations" and the FCC's preemption order would have been struck down. Cal. Pet. 13-14.

But the Fourth Circuit's decision turned on the intrinsic nature of the FCC's regulations, not on the vagaries of the states' response. The Court noted that "separation of terminal equipment used exclusively for local communication is a practical and economic impossibility," and that, in itself, was sufficient grounds to warrant FCC preemption. 552 F.2d at 1043. The same is true here: the use of separate facilities just for the intrastate portion of jurisdictionally mixed enhanced service is a practical and economic impossibility.

The decision below is also consistent with a number of decisions from the D.C. Circuit. In *Computer and Communications Industry Association v. FCC* ("CCIA"), 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983), for example, the Court upheld the FCC's *Computer II* order—adopted under its Title I authority—which preempted states from tariffing customer premises equipment ("CPE") such as telephones. In doing so, the court directly considered whether the FCC could preempt under its Title I power. The court held that it could, stating that "we perceive no critical distinction between preemption by Title II regulation and preemption by the exercise of ancillary [that is, Title I] jurisdiction." *CCIA*, 693 F.2d at 217 (footnote omitted).

Since *Louisiana*, the D.C. Circuit has on three other occasions reaffirmed that the FCC may preempt state regulations under Title I. In *Illinois Bell Telephone Company v. FCC*, 883 F.2d 104 (D.C. Cir. 1989), that court upheld an FCC order—based expressly on Title I—that

preempted state regulation inconsistent with an FCC rule requiring the BOCs to pay commissions to noncarrier CPE vendors that market certain BOC services. Similarly, in *National Association of Regulatory Utility Commissioners v. FCC* ("*NARUC III*"), 880 F.2d 422 (D.C. Cir. 1989), the D.C. Circuit affirmed a portion of a Commission order—also based on the FCC's Title I powers—that preempted state tariff regulation of carrier-provided wiring on the customer's premises. And in *Public Service Commission v. FCC*, 909 F.2d 1510 (D.C. Cir. 1990), the court affirmed the preemption of state regulation of the rates of "DNP," a BOC-provided billing and collection service subject to the FCC's Title I jurisdiction. In all three cases, the court expressly relied on this Court's *Louisiana* decision.

5. Finally, contrary to the suggestion of the State of New York, the decision below does not undermine the "dual regulatory system" and "leave the nation with a 'one fits all' agenda." N.Y. Pet. 26. As this Court noted in *Louisiana*, 476 U.S. at 360, "the realities of technology and economics belie . . . a clean parceling of responsibility" between state and federal authorities. On some matters, it will simply be "*not* possible to separate the interstate and the intrastate components." *Id.* at 375 n.4. And, on those matters, federal regulators must prevail. The alternative would be balkanization of the nation's telephone system and emasculation of the FCC's plenary, statutory authority over interstate communications.

CONCLUSION

The petitions for a writ of certiorari should be denied.

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No. 94-1173 and 94-1213

In the Supreme Court of the United States

OCTOBER TERM, 1994

STATE OF CALIFORNIA AND CALIFORNIA PUBLIC UTILITIES COMMISSION, PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

STATE OF NEW YORK, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Communications Commission has statutory authority to preempt state regulation of services that are used inseparably for interstate and intrastate communications where the preempted state regulation would defeat the Commission's regulation of the same services.

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In the Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-1173

STATE OF CALIFORNIA AND CALIFORNIA PUBLIC UTILITIES COMMISSION, PETITIONERS

v.

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FEDERAL COMMUNICATIONS COMMISSION, ET AL.

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BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A34) is reported at 39 F.3d 919.[1] The Federal Communications Commission's report and order (Pet. App. B1-110) is reported at 6 F.C.C. Rcd 7571.

[1] Unless otherwise noted, "Pet. App." will refer to the appendix to the petition in No. 94-1173.

JURISDICTION

The judgment of the court of appeals was entered on October 18, 1994. The petition for a writ of certiorari in No. 94-1173 was filed on January 3, 1995, and the petition in No. 94-1213 was filed on January 6, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

The Federal Communications Commission (Commission or FCC) issued an order preempting three narrow categories of regulation by States of certain services offered by local telephone companies. The court of appeals affirmed that aspect of the agency's action. *California* v. *FCC*, 39 F.3d 919 (Pet. App. A1-A34).

1. This case arises out of several FCC decisions designed to facilitate the provision of enhanced services—a combination of basic telephone service and various computer processing applications—such as WESTLAW, Dow Jones News, and voice mail or remote monitoring services.[2] To that end, the Commission abolished a rule that formerly required telephone operating companies owned by the regional Bell holding companies (BOCs) to offer enhanced services only

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[2] The FCC's decisions were reflected in a series of orders known as "*Computer III*." See *Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry) - Phase I, Report and Order*, 104 FCC 2d 958 (1986), recon., 2 FCC Rcd 3035 (1987), further recon., 3 FCC Rcd 1135 (1988), second further recon., 4 FCC Rcd 5927 (1989), *Phase I Order* and *Phase I Reconsideration* vacated, *California* v. *FCC*, 905 F.2d 1217 (9th Cir. 1990) (*California I*); *Phase II, Report and Order*, 2 FCC Rcd 3072 (1987), recon., 3 FCC Rcd 1150 (1988), further recon., 4 FCC Rcd 5927 (1989), *Phase II Order* vacated, *California I*, 905 F.2d 1217 (9th Cir. 1990).

through subsidiaries that were structurally separate from the BOCs' common carrier operations. The purpose of the requirement of structural separation was to deter anticompetitive behavior by the BOCs, such as cross-subsidization and discrimination against competing enhanced-service providers in offering access to the telephone network. The Commission replaced the rule requiring structural separation with nonstructural safeguards designed to prevent anticompetitive behavior without imposing on BOCs the costs of structural separation.

In connection with its new regulatory approach, the Commission originally preempted nearly all state regulation of enhanced services offered by common carriers. See Pet. App. B81. The court of appeals, however, vacated the Commission's orders. *California* v. *FCC*, 905 F.2d 1217 (9th Cir. 1990) (*California I*). The court noted that Section 2(b) of the Communications Act of 1934, 47 U.S.C. 152(b), denies the FCC jurisdiction "with respect to * * * regulations for or in connection with intrastate communication service by wire or radio of any carrier." 905 F.2d at 1239. The Court also noted that under *Louisiana Pub. Serv. Comm'n* v. *FCC*, 476 U.S. 355 (1986) (*Louisiana PSC*), the FCC may preempt state regulation of intrastate communications, notwithstanding Section 2(b), when the state regulation effectively negates the exercise by the FCC of its own lawful authority over interstate communication. 905 F.2d at 1242-1243. The court concluded, however, that the FCC's broad preemption orders could not be upheld under that "impossibility" exception to Section 2(b), because the record did not demonstrate "that *all* state-imposed separation requirements" and nonstructural safeguards preempted by the FCC would negate the FCC's policy of permitting the integration of basic and

enhanced services offered on an interstate basis. 905 F.2d at 1243-1245. The Court remanded the case to the Commission to reconsider, *inter alia*, the scope of its preemption action.

2. In light of the court of appeals' decision, the Commission sought further comment on whether and to what degree it should preempt state regulatory policies governing enhanced services. See *Computer III Remand Proceedings: Bell Operating Company Safeguards* (CC Docket No. 90-623), Notice of Proposed Rulemaking, 6 FCC Rcd 174 (1990). The Commission then narrowed the scope of preemption to include only: (1) state requirements for structural separation of personnel and facilities used to provide the intrastate portion of jurisdictionally mixed enhanced services, (2) state rules governing access to customer proprietary network information (CPNI) that are inconsistent with those imposed by the FCC; and (3) state rules requiring that certain technical network information be released at a time different from that required by the FCC's disclosure rule. Pet. App. B89-B90. The Commission preempted those three areas because it concluded that state action concerning those matters would negate the FCC's own regulations of enhanced services.[3] The Commission did not preempt state tariff and rate regu-

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[3] The FCC concluded that state structural separation rules would force carriers to segregate their interstate and intrastate operations, thereby negating the FCC's integration goals. Pet. App. B92-B96. State CPNI access restrictions would have a similar impact because personnel subject to a state access restriction would not be able to access CPNI where permitted under the federal rule. Pet. App. B97. And because initial disclosure of network information may occur but once, a state rule requiring disclosure earlier than the FCC's rule would negate the FCC's rule and its underlying policies. Pet. App. B98.

lation of intrastate services, either where the services were purely intrastate or where they were jurisdictionally mixed.

3. The court of appeals affirmed the preemption aspect of the Commission's order. Pet. App. A1-A34. The court first reaffirmed its holding that *Louisiana PSC* recognizes an "impossibility" exception to Section 2(b). Pet. App. A30. The court then rejected petitioners' contention that the exception applies only when the Commission acts pursuant to specific regulatory duties prescribed by Title II of the Communications Act of 1934, 47 U.S.C. 201 *et seq.*, such as setting rates, but not when it acts to implement the more general goals of Title I—*i.e.*, to "make available, so far as possible * * * a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges." 47 U.S.C. 151. Pet. App. A31. The court explained that *Louisiana PSC* recognized that Section 2(b) is a limitation on the Commission's authority that applies equally to Titles I and II of the Act, and that it would accordingly make little sense to conclude that the impossibility exception applies only to the Commission's actions under Title II. See Pet. App. A31-A32.

The court of appeals noted that this Court's opinion in *Louisiana PSC* cited two Fourth Circuit cases, *North Carolina Utils. Comm'n* v. *FCC*, 537 F.2d 787, cert. denied, 429 U.S. 1027 (1976), and *North Carolina Utils. Comm'n* v. *FCC*, 552 F.2d 1036, cert. denied, 434 U.S. 874 (1977) (the *NCUC* cases), as examples of situations that would meet the impossibility exception. The court of appeals observed that in those cases:

> the Fourth Circuit upheld the FCC's preemption of state regulations barring the use of customer

> provided telephone equipment for intrastate service, because they conflicted with the FCC's regulations allowing customers to provide their own telephones for interstate service. The Fourth Circuit acknowledged that it was possible to comply with both the states' and the FCC's regulations: customers could have one telephone for interstate use and one for intrastate use. The court nevertheless agreed with the FCC that it was highly unlikely, due to practical and economic considerations, that customers would maintain two separate phones and, therefore, [the result would be] that customers would use telephone company equipment to comply with state regulations.

Pet. App. A33 (citing *NCUC*, 552 F.2d at 1043). The court found the FCC's preemption of structural separation requirements in this case analogous to the FCC's actions in the *NCUC* cases, because the record demonstrated that the BOCs "would be forced to comply with the state's more stringent requirements, or choose not to offer certain enhanced services, thereby defeating the FCC's more permissive policy of integration." Pet. App. A33. The court similarly concluded that compliance with conflicting state and federal CPNI and network disclosure regulations "would in effect be impossible." *Id.* at A34.

With respect to the substantive parts of the Commission's rulemaking proceeding, the court of appeals affirmed in part and reversed in part. The court held that the Commission had failed to explain adequately its decision to remove the structural separation requirement from the BOCs in light of what the court regarded as a dilution of the Commission's safeguards against access discrimination. Pet. App. A26-A27, A34. The court therefore remanded the case to the

Commission for further consideration of the question of removing the structural separation requirement. In a Notice of Proposed Rulemaking responding to that remand, the Commission has once again asked for comment on the costs and benefits of removing the structural separation requirement from the BOCs. *Computer III Further Remand Proceedings* (CC Docket No. 95-20), Notice of Proposed Rulemaking, FCC 95-48 (released Feb. 21, 1995).

ARGUMENT

The court of appeals correctly decided the narrow preemption issue presented by the petitions in accordance with well-established precedent. Its decision does not conflict with the decision of any other court of appeals. Further review is not warranted.

1. The Communications Act of 1934 (the Act) establishes "a system of dual state and federal regulation over telephone service." *Louisiana Pub. Serv. Comm'n* v. *FCC*, 476 U.S. 355, 360 (1986) (*Louisiana PSC*). Under Section 1 of the Act, "[i]nterstate communications are totally entrusted to the FCC," which is charged with providing a "rapid, efficient, Nation-wide" wire and radio communication service. *National Ass'n of Reg. Util. Comm'rs* v. *FCC*, 746 F.2d 1492, 1498 (D.C. Cir. 1984) (quoting 47 U.S.C. 151). Regulatory authority over "intrastate communication service by wire or radio" is withheld from the federal agency pursuant to Section 2(b) of the Act, 47 U.S.C. 152(b).

Although Sections 1 and 2 thus superficially appear to create two distinctly separate spheres of regulation, this Court has recognized that the "realities of technology and economics" blur the boundary line between federal and state regulatory domains. *Louisiana PSC*, 476 U.S. at 360. See also *Public Utility Comm'n of Texas* v. *FCC*,

886 F.2d 1325, 1329 (D.C. Cir. 1989) (*Texas PUC*). Congress has addressed that problem in the context of ratemaking by authorizing a jurisdictional separations process to segregate interstate costs from intrastate costs. 47 U.S.C. 221(c), 410(c). The jurisdictional separations process produces cost information that enables each jurisdiction to regulate the rates for service within its own purview without intruding on the ratemaking "hemisphere" of the other. *Louisiana PSC*, 476 U.S. at 375.

With respect to regulation that does not primarily concern rates, however, the interstate and intrastate aspects of telephone facilities or services cannot be separated so easily. For example, virtually all telephone plant that is used to provide interstate service also is used to provide intrastate service. *Louisiana PSC*, 476 U.S. at 360. Thus, non-ratemaking regulation of telephone lines and equipment almost inevitably affects both interstate and intrastate communications. See, *e.g.*, *Texas PUC*, 886 F.2d at 1333-1335; *North Carolina Utils. Comm'n* v. *FCC*, 552 F.2d 1036 (4th Cir.) (*NCUC II*), cert. denied, 434 U.S. 874 (1977); *North Carolina Utils. Comm'n* v. *FCC*, 537 F.2d 787 (4th Cir.) (*NCUC I*), cert. denied, 429 U.S. 1027 (1976).

In *Louisiana PSC*, this Court held that the FCC lacks authority to preempt state regulations governing the depreciation, for intrastate ratemaking purposes, of telephone plant and equipment. The Court reasoned that "the jurisdictional limitations placed on the FCC by [47 U.S.C.] 152(b), coupled with the fact that the Act provides for a 'separations' proceeding to determine the portions of a single asset that are used for interstate and intrastate service," foreclose the Commission from preempting state regulation of intrastate rates. 476 U.S. at 369. The Court noted that it is "certainly possible to

apply different rates and methods of depreciation * * * once the correct allocation between interstate and intrastate use has been made." *Id.* at 375 (citing 47 U.S.C. 221(c), 410(c)).

At the same time, the Court recognized the absence of clear jurisdictional boundaries for regulation of communications outside the ratemaking context. The Court thus distinguished its decision, which depended so significantly on the separations-defined boundary between interstate and intrastate *rates*, from cases "in which FCC preemption of state regulation was upheld where it was *not* possible to separate the interstate and the intrastate components of the asserted FCC regulation." *Louisiana PSC*, 476 U.S. at 375 n.4 As the court of appeals noted, *Louisiana PSC* cited the Fourth Circuit's *NCUC* cases as examples of situations that would meet that "impossibility exception." The court of appeals correctly applied the teaching of those cases to conclude that the FCC's narrow preemption of inconsistent state action here is permissible, because the FCC regulations concern only jurisdictionally mixed enhanced services, Pet. App. A31, and compliance with both state and federal regulations, while technically feasible, is "in effect * * * impossible." *Id.* at A32-A34.

2. Petitioners are wrong to contend (New York Pet. 14-15; California Pet. 10-12) that the impossibility exception does not apply at all when the FCC's purpose is to avoid frustration of rules it adopts pursuant to Section 1 of the Act, 47 U.S.C. 151. The Act does not distinguish between preemption in support of the general provisions of the Act (*e.g.*, Section 1) and preemption in support of actions taken pursuant to explicit statutory authority (*e.g.*, Title II), and no case from this Court or any court of appeals has placed significance on the distinction on which petitioners rely. Indeed, in *Capital*

Cities Cable, Inc. v. *Crisp*, 467 U.S. 691, 708 (1984), the Court affirmed the FCC's preemption of state regulations that interfered with its Section 1 mandate.[4] See also *Public Service Comm'n of Maryland* v. *FCC*, 909 F.2d 1510, 1512-1516 (D.C. Cir. 1990) (*Maryland PSC*) (applying impossibility doctrine to FCC orders issued solely under Title I of the Act). The Court reached a similar conclusion under the Federal Power Act, in resolving conflicts between a federal agency's general statutory goals and the States' statutory authority over intrastate regulation. See *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988) (upholding preemption under FERC's broad statutory charge to promote development of interstate power pools despite express statutory reservation of authority to the States to oversee retail sales); see also *City of New York* v. *FCC*, 486 U.S. 57, 66-70 (1988).

Moreover, *Louisiana PSC* did not, as the New York petitioners contend (New York Pet. 19-21), limit the impossibility exception to situations where the FCC has exercised its statutory authority over common carriers under Title II of the Act. Footnote 4 of the Court's opinion, which discussed the impossibility exception, is part of the Court's discussion of the significance of jurisdictional separations proceedings, which responded to the Commission's preemption theories under *both* Title I (Section 151) *and* Title II (Section 220): "In our view, the jurisdictional limitations placed on the FCC by

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[4] *Capital Cities* did not involve Section 2(b), but its reasoning is consistent only with the proposition that the FCC's authority to preempt is as great under Section 1 as under the more explicit provisions of other Titles. See *Computer & Communications Industry Ass'n* v. *FCC*, 693 F.2d 198, 217 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983).

§ 152(b), *coupled with* the fact that the Act provides for a 'separations' proceeding to determine the portions of a single asset that are used for interstate and intrastate service, 47 U.S.C. § 410(c), answer *both* preemption theories." *Louisiana PSC*, 476 U.S. at 369 (emphasis added). The Court did not even begin to analyze the Commission's Title II (Section 220) preemption argument until the subsection of *Louisiana PSC* that *follows* footnote 4. See *Louisiana PSC*, 476 U.S. at 376-378. Furthermore, contrary to petitioners' claim (New York Pet. 21-22), the *NCUC* cases that this Court cited to illustrate the scope of the exception involved the FCC's exercise of preemptive authority under *both* Title I *and* Title II. See *NCUC II*, 552 F.2d at 1043, 1046-1047. Indeed, the New York petitioners elsewhere concede that point, admitting that "[i]n upholding the FCC's action[s], the Fourth Circuit * * * endorsed [S]ection 151 as a source of preemptive powers." New York Pet. 10.

3. The California petitioners are also wrong to suggest (California Pet. 10-12) that the court of appeals misapplied the impossibility exception because that exception requires physical impossibility. As the court of appeals explained (Pet. App. A33), the *NCUC* cases specifically recognized that compliance with state and federal rules, while technically feasible in the sense that each customer could have different telephones for interstate and intrastate use, was not possible as a practical matter. See *NCUC II*, 552 F.2d at 1043, 1049; *NCUC I*, 537 F.2d at 791. The key element of the Fourth Circuit's reasoning was that it was "not feasible, as a matter of economics and practicality of operation, to limit the use of [the] equipment to either interstate or intrastate transmissions." *NCUC I*, 537 F.2d at 791. That is the same legal principle on which the decision below turned (see Pet. App. A32-A33), and there is

accordingly no merit to petitioners' claim (California Pet. 12-17) that the ruling below conflicts with the *NCUC* cases.[5]

The California petitioners also suggest in passing (California Pet. 16 n.15) that the court of appeals' decision conflicts with the D.C. Circuit's decision in *Maryland PSC*, because the D.C. Circuit "recognized" in that case that economic burdens cannot justify preemption. That argument mischaracterizes *Maryland PSC*. In that case, the D.C. Circuit expressed "doubt" that preemption of a state regulation could be justified "simply on the grounds * * * that it imposes too great an economic burden on carriers engaged in both interstate and intrastate communications." 909 F.2d at 1516. The court went on to hold, however, that regulations of intrastate communications *can* be

---

[5] The California petitioners claim that, unlike the *NCUC* cases, the "decision below allows the FCC to unilaterally define a situation of 'impossibility' " and thereby preempt state regulation "whenever the FCC believes that compliance with state requirements would either be too costly or too burdensome for the company." California Pet. 14, 16. The New York petitioners similarly contend (New York Pet. 25) that the court of appeals' decision will lead to a "slippery slope * * * empower[ing] FCC officials to preempt whatever state regulation stands in the way of" their general objectives. The court of appeals, however, did not purport to hold that the Commission has unreviewable discretion to preempt state regulations whenever it deems that course advisable. To the contrary, the history of this litigation, especially the court's vacatur of the Commission's original preemption orders, belies that broad reading of the court's opinion. The court merely held that the record in this case justifies the FCC's conclusion that economic and operational factors make the separation of mixed jurisdictional services and facilities practically impossible. Pet. App. A32, A34. Petitioners do not contend that that factual conclusion warrants this Court's review.

preempted if those regulations "impose costs on interstate service that the FCC believes are unwarranted" and the interstate and intrastate aspects cannot feasibly be "unbundled." *Ibid.* See also *Texas PUC*, 886 F.2d at 1332-1334; *Illinois Bell Telephone Co.* v. *FCC*, 883 F.2d 104, 113-115 (D.C. Cir. 1989); *National Ass'n of Reg. Util. Comm'rs* v. *FCC*, 880 F.2d 422, 430 (D.C. Cir. 1989). That analysis closely parallels the views expressed by the court of appeals in this case. See Pet. App. A32-A34.

Finally, review of petitioners' claims is not warranted for the additional reason that it is unclear at present what form the FCC's substantive regulations concerning separation will ultimately take. As we have noted (p. 7, *supra*), following the Ninth Circuit's remand on the substantive regulatory issues, the Commission issued a Notice of Proposed Rulemaking requesting comment, *inter alia*, on whether a balance of the relevant costs and benefits justifies the removal of structural separation. If the Commission should decide not to remove structural separation, there would be no occasion for this Court to consider the degree to which States may interfere with current federal regulatory choices concerning separation.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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No. 94-1173, 94-1213

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1994

PEOPLE OF THE STATE OF CALIFORNIA, ET. AL.

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, ET. AL.

Respondents.

STATE OF NEW YORK, ET. AL.

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, ET. AL.

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES, AND FORTY-TWO STATE COMMISSIONS, CONSUMER ADVOCATES, AND ATTORNEYS GENERAL JOINT BRIEF AS AMICI CURIAE IN SUPPORT OF PETITIONERS CALIFORNIA AND NEW YORK

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QUESTION PRESENTED

Whether the Federal Communications Commission
("FCC" or "Commission")
may lawfully preempt State regulation applicable solely
to the intrastate services of a local telephone company
("LEC" or "Carrier")
whenever the FCC believes that such State regulation would make
it more expensive or difficult to achieve its § 151 - derived
policy of encouraging the LECs to be more efficient?

LIST OF PARTIES

A - Petitioners & Respondents

MCI Telecommunications Corporation - Petitioner

Newspaper Association of America - Petitioner

People of the State of California & Public Utilities Commission of the State of California - Petitioners

Public Service Commission of the State of New York - Petitioner

Federal Communications Commission & the United States of America - Respondents

B - Others

Ad Hoc Telecommunications Users Committee
ADT Security Systems
American Telephone and Telegraph Company
Ameritech Corporation
Association of Telemessaging Services International
Bell Atlantic Telephone Companies
[Bell Atlantic Corporation]
[Bell Atlantic Systems Leasing International, Inc.]
[Bell Atlantic Tricon Leasing Corporation]
[Bell Atlantic Financial Services, Inc.]
[Bell Atlantic Mobile Systems, Inc]
[Bell Atlantic Network Funding Corporation]
[Bell Atlantic Capital Funding Corporation]
BellSouth Corp. & BellSouth Telecommunications, Inc.
California Cable Television Association

List of Parties (Continued)

Compuserve, Inc.
District of Columbia Public Service Commission
Florida Public Service Commission
GTE Service Corporation
H&R Block, Inc.
Information Industry Association
Information Technology Association America
Maryland People's Counsel
Metromedia Paging Services
National Association of Regulatory Utility Commissioners
NYNEX Corporation
[New York & New England Telephone]
Pacific Telesis Group
[Pacific Bell and Nevada Bell]
Pennsylvania Office of Consumer Advocate.
Pennsylvania Public Utility Commission.
Southwestern Bell Telephone Company
[Southwestern Bell Corporation]
[Southwestern Bell International Holdings Corporation]
[Southwestern Bell Publications, Inc.]
[Southwestern Bell Telecommunications, Inc]
[Southwestern Bell Mobile Systems, Inc.]
Sprint Communications Company
Telecom Corporation of New Zealand
United States Telephone Association
U.S. West Communications, Inc.
Voice-Tel Enterprises

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No. 94-1173, 94-1213

IN THE
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THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES, AND FORTY-TWO STATE COMMISSIONS, CONSUMER ADVOCATES, AND ATTORNEYS GENERAL JOINT BRIEF AS AMICI CURIAE IN SUPPORT OF PETITIONERS CALIFORNIA AND NEW YORK

I. INTEREST OF *AMICI CURIAE*

A. National Association of Regulatory Utility Commissioners:

The National Association of Regulatory Utility Commissioners ("NARUC") is a quasi-governmental nonprofit organization founded in 1889.

NARUC, which Congress calls "the national organization of the State commissions", 47 U.S.C.A. § 410(c) (1971), presents the collective interest of State commissions charged with regulating conditions of service of the intrastate operations of electric, natural gas and telephone utilities. Both Congress and the Federal courts have long recognized that NARUC is a proper party to represent the collective interest of State regulatory commissions.[1]

NARUC's member commissions, which includes both the New York ("NY PSC") and California ("CPUC") commissions, are obligated under State law to ensure that the rates charged to retail consumers are just and reasonable. NARUC's mission is to serve the public interest by seeking to improve the quality and effectiveness of public utility regulation in America.

NARUC participated in all phases of the proceeding below and is concerned about the substantial threat to State jurisdiction posed by the order on review.

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[1] *See, for example, United States of America v. Southern Motor Carrier Rate Conference, et al.*, 467 F.Supp. 471 (N.D. Ga. 1979), *aff.* 672 F.2d 469 (5th Cir. Unit "B" 1982); *aff. en banc*, 702 F.2d 532 (5th Cir. Unit "B" 1983, *rev'd*, 471 U.S. 48 (1985). *See also, Indianapolis Power and Light Co. v. Interstate Commerce Commission*, 587 F.2d 1098 (7th Cir. 1982); *Washington Utilities and Transportation Commission v. FCC*, 513 F.2d 1142 (9th Cir. 1976).

B. National Association of State Utility Consumer Advocates:

The National Association of State Utility Consumer Advocates ("NASUCA") joins in this Brief. NASUCA is an association of 42 consumer advocate offices in 38 States and the District of Columbia, whose members are designated by State law to represent the interests of utility consumers before State and Federal regulators and in the courts.

C. Individual State Commissions, Consumer Advocates & Attorney Generals: Numerous individual State entities, noting the potential impact of the Ninth Circuit's opinion, contacted NARUC to individually join in this brief and express their strong support for the NY PSC and CPUC petitions. As described earlier, State Commissions have the responsibility to regulate intrastate telecommunications utility operations to prevent harm to the public interest. Generally, State Consumer Advocates have the responsibility to represent utility ratepayers before their respective State commissions and in the courts. State Attorney Generals have similar duties. The following have joined in this brief:

1 - Alabama Public Service Commission

2 - Alaska Public Utilities Commission

3 - Arkansas Public Service Commission

4 - Arkansas Attorney General
for the State of Arkansas

5 - Arizona Public Service Commission

6 - Colorado Attorney General
for Public Utilities Commission of Colorado

7 - Colorado Office of Consumer Counsel

8 - Attorney General for State of Connecticut & the
Connecticut Department of Public Utility Control

9 - Public Service Commission of the District of Columbia

10 - Florida Office of Public Counsel

11 - Florida Public Service Commission

12 - Hawaii Public Utilities Commission

13 - Idaho Public Utilities Commission

14 - Illinois Commerce Commission

15 - Indiana Utility Regulatory Commission

16 - Iowa Utilities Board

17 - Kansas Corporation Commission

18 - Kentucky Public Service Commission

19 - Maryland People's Counsel

20 - Michigan Attorney General
for the State of Michigan

21 - Michigan Attorney General
for the Michigan Public Service Commission

22 - Minnesota Attorney General
for the Minnesota Public Utilities Commission

23 - Missouri Office of the Public Counsel

24 - Missouri Public Service Commission

25 - Montana Public Service Commission

26 - New Hampshire Public Utilities Commission

27 - Attorney General for the State of New Mexico

28 - North Dakota Attorney General
for the North Dakota Public Service Commission

29 - Ohio Attorney General
for the Public Utilities Commission of Ohio

30 - Oregon Public Utility Commission

31 - Pennsylvania Office of Consumer Advocate

32 - Pennsylvania Public Utility Commission

33 - Attorney General for State of Rhode Island
and Providence Plantations

34 - Rhode Island Public Utilities Commission

35 - Public Service Commission of South Carolina

36 - South Dakota Public Service Commission

37 - Utah Public Service Commission

38 - Vermont Attorney General
for the State of Vermont

39 - Vermont Public Service Board

40 - Virginia State Corporation Commission

41 - West Virginia Public Service Commission

42 - Wyoming Public Service Commission

II. REASONS TO GRANT THE WRIT

The opinion below directly conflicts with this Court's holding in *Louisiana Public Service Commission v. FCC* ("*Louisiana*"), 476 U.S. 355 (1986), and, if upheld, essentially eliminates § 152(b)'s, 47 U.S.C.A. § 152(b), reservation of authority to the States from the Communications Act, thereby leaving valid State communications regulation subject to the preemptive caprice of the FCC.

Under the Ninth Circuit-sanctioned preemption standard, the FCC could preempt State regulation of the intrastate portion of "jurisdictionally mixed" services any time such regulation imposes any added costs or alleged "inefficiencies" on the local telephone company. This Court's opinion in *Louisiana* clearly indicates that, because of § 152(b), the FCC's jurisdictional reach is much more limited.

Because of the extreme and deleterious impact upon the ability of State regulatory commissions to effectively regulate intrastate telecommunications that could well ensue should the Ninth Circuit's decision below stand, *Amici* join in submitting this brief [2] in support of the NY PSC and CPUC petitions for certiorari.

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[2] Pursuant to Rule 37.2, U.S. Supr.Ct. Rule 37, 28 U.S.C.A. (1994), *Amici* have obtained the consent of the parties to the filing of this brief and is filing them concomitantly. All other signatories to this brief are "authorized law officer[s]" within the meaning of Rule 37.5.

III. OPINION AND JUDGEMENTS BELOW

The opinion below is reported at *People of the State of California v. Federal Communications Commission*, No. 92-70083 (9th Cir. Oct. 18, 1994) ("*California II*"). The underlying FCC order "In the Matter of Computer III Remand Proceedings; Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards," CC Docket 90-623, Report and Order, is reported at 6 F.C.C. Rec 7571 (1991), Both are reproduced in the Appendix of the CPUC petition at A1-34 and B1-110 respectively.

IV. JURISDICTIONAL STATEMENT

The judgement below was entered on October 18, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

V. STATUTORY PROVISIONS AT ISSUE

Relevant statutory provisions are reproduced in the Appendix of the CPUC petition at C1-2.

VI. STATEMENT OF THE CASE

Amici adopts the statements of facts presented by the NY PSC and the CPUC. See, NY PSC petition at 6; CPUC petition at 2.

VII. SUMMARY OF ARGUMENT

As a matter of law, *California II* and this Court's ruling in *Louisiana* are identical. In *California II*, as in *Louisiana*, the FCC defended rules prescribed to further § 151 goals by encouraging efficiency and conceded that the carriers could comply with both State and interstate rules. To justify the preemption proposed in *California II*, the FCC relied on an economic impractibility argument identical to that rejected in *Louisiana*. Nonetheless, the Ninth Circuit essentially ignored *Louisiana*, and upheld FCC preemption based solely upon the FCC belief that State regulation confined to intrastate services would "essentially negate" the very same § 151-derived "federal policies" favoring efficiency referenced in *Louisiana*. Under this construct, the FCC's potentially unlimited preemptive reach could extend to areas clearly within the ambit of § 152(b)'s reservation of State authority, e.g., Caller ID rules and telemarketing regulation.

VIII. ARGUMENT

Amici support all arguments presented in the NY PSC and CPUC petitions. Mindful of Rule 37.1's admonishment, U.S. Supr.Ct. Rule 37.1, 28 U.S.C.A., *Amici* seek only to augment those arguments with brief discussions of (a) related arguments relevant to questions posed by the writs and (b) the potential practical impact of the Ninth Circuit opinion.

A. *California II* ignores and, if left intact, effectively overrules this Court's teachings in *Louisiana*.

Section 152(b), 47 U.S.C. § 152(b) (1990), states: "[N]othing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service by wire or radio of any carrier..."

On its face, the statute is clear. Preemption of State regulation of intrastate "communications services" confined to the intrastate sphere is not allowed. Indeed, this Court has characterized this section as "...not only impos[ing] jurisdictional limits on the power of [the FCC], but also...provid[ing] its own rule of statutory construction." (Emphasis Added) *Louisiana*, 476 U.S. 355, 373, 376 n. 5, 106 S.Ct. 1890, 90 L.Ed.2d 359, 384, 387 n. 5(1986).

However, this Court's exegesis of § 152(b) in *Louisiana* is essentially overruled by the Ninth Circuit's opinion; as a matter of law, the circumstances underlying *Louisiana* and the decision below are indistinguishable. Nonetheless, the Ninth Circuit reaches a conclusion that is diametrically opposed to the rationale adopted by this Court in *Louisiana*.

In *Louisiana*, the FCC argued that § 220 of the Act, 47 U.S.C. § 220, which deals explicitly with depreciation, "operates automatically to preempt inconsistent State action." Alternatively, the Commission argued, based on § 151, that "federal displacement of State regulation is justifiable under the Act when necessary 'to avoid frustration of validly adopted federal policies'." Id. 476 U.S. at 362, 90 L.Ed.2d at 377. In describing the boundaries of § 152(b) of the Act, the court rejected both arguments, even in the face of evidence that, in so doing, they would be threatening "..the financial ability of the industry to achieve the technological progress and provide the quality of service that the Act was passed to promote." Id. 476 U.S. at 358, 90 L.Ed.2d. at 375. Thus, the opinion makes clear that the FCC can not legitimately preempt State action which frustrates federal policy under § 151 to develop an "efficient, nationwide communications network," just because such action supposedly "jeopardize[s] the continuing viability of the telecommunications industry." Id. 476 U.S. at 368 & 370, 90 L.Ed.2d at 381 & 382.[3]

In *California II*, the FCC adopted an identical posture (1) defending, as in *Louisiana*, regulations prescribed to

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[3] Interestingly, time has vindicated this Court's interpretation of the Congressional intent embodied in Section 152(b). The dire predictions leveled by the FCC in Louisiana, concerning the deleterious impact on the network of separate State intrastate regulations, have failed to materialize.

further § 151 goals by encouraging efficiency and competitiveness, *Louisiana*, 476 U.S. at 369; 90 L.Ed.2d at 382; *California II*, slip op. at 12756, CPUC App. at A15, (2) conceding, also as in *Louisiana*, that the phone companies could comply with both State and interstate regulation, and finally, (3) relying on an economic impractibility argument identical to that rejected in *Louisiana*, i.e., contending that otherwise valid State regulations affecting the intrastate portion of dual use facilities must be preempted because they would undermine the above-mentioned § 151-derived efficiency goals.[4]

In *Louisiana*, this Court reversed FCC preemption in spite of (1) clear inefficiencies caused by requiring carriers to keep differing inter- and intrastate depreciation regimes and (2) arguments that such inefficiencies would "frustrate federal policies." Rather, this Court found that the FCC failed to demonstrate that the subject intrastate regulations prevented the FCC from promulgating enforceable interstate regulations. Id. 476 U.S. at 369, 376; 90 L.Ed.2d at 382, 386.

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[4] "Here...the FCC acknowledges that the BOCs could comply with structural separation requirements, but contends that it would not be economically or operationally feasible for them to do so. The BOCs would be forced to comply with the state's more stringent requirements, or choose not to offer certain enhanced services, thereby defeating the FCC's more permissive policy of integration." See, *California II*, slip op. at 12774-5, CPUC App. at A33-34; Cf. *Louisiana*, 476 U.S. at 369, 375; 90 L.Ed.2nd 382, 385.

In stark contrast, in *California II*, the Ninth Circuit essentially overrules *Louisiana*, and upholds FCC preemption based solely upon the FCC belief that State regulation confined to intrastate services would "frustrate" or "essentially negate" the very same § 151-derived "federal policies" favoring efficiency and competition referenced in *Louisiana*.

Under the Ninth Circuit's construct, the FCC can preempt any time separate State regulation of the intrastate aspects of dual use facilities, though possible, causes economic inefficiencies because the carrier may actually have to comply with the dual regulation explicitly contemplated by § 152(b). Thus, the Ninth Circuit has sanctioned what Congress has expressly forbidden - a radical restructuring of the Communications Act into a single federal jurisdictional scheme. Accordingly, we urge the Court to reverse the opinion below.

B. *California II* allows the FCC to ignore § 152(b) and preempt valid State regulatory initiatives.

As the CPUC has aptly stated, the Ninth Circuit's ruling "elevates the FCC to a court of review of State regulation of intrastate service on issues of cost and efficiency." CPUC petition at page 9. Basically, under the Ninth Circuit-sanctioned preemption standard, the FCC could preempt State regulation of the intrastate portion of

"jurisdictionally mixed" or "dual use" services, any time such regulation will impose any added costs or alleged "inefficiencies" on the local telephone company.

Accordingly, as a practical matter, the potential reach of the Ninth Circuit's overbroad rationale are enormous. The pending FCC Caller Identification ("CID") proceeding [5] provides a case in point. As described below, the FCC has established new blocking requirements which, in many instances, are not consistent with State blocking regimes that have been in place for several years.[6]

A customer subscribing to CID services can access a display of either the phone number or last name of the person calling before answering the call. The two methods most often deployed with CID service for protecting caller privacy are per call and per line blocking. Per line blocking bars disclosure of the calling number automatically for all calls emanating from a particular subscriber line. Per call blocking

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[5] On March 28, 1994, the FCC released its "Report and Order and Further Notice of Proposed Rulemaking" ("R&O"), 9 FCC Rcd 1764; 74 Rad. Reg. 2d (P&F) 989, as adopted *In the Matter of Rules and Policies Regarding Calling Number Identification Service* in CC Docket 91-281.

[6] Although the Virginia State Corporation Commission did not participate in this FCC docket because of its per call intrastate CID regime, it also believes that, as separate interstate and intrastate blocking regimes are possible, States should have the right to select the form of blocking best suited for that State's intrastate services.

bars disclosure of the calling number only when a code is punched in immediately before dialing a particular phone number.

The FCC's R&O adopts rules, effective April 1995, for interstate CID-based services, making them available nationwide by requiring all carriers to pass to connecting carriers, without charge, the calling party number parameter. The rules also require, for the proposed interstate CID services, free per call blocking and prohibit per line blocking.

As in both *Louisiana* and *California II*, in the CID proceeding, there is record evidence indicating that separate inter- and intrastate blocking regimes are possible. Indeed, forty-one States have already authorized some form of per line blocking for intrastate services.

Nonetheless, at least four parties, responding to the invitation implicit in the R&O, have sought reconsideration of the R&O. They claim that any inconsistent blocking regime for intrastate services must also be preempted, and they cite, inter alia, the economic inefficiency of maintaining separate inter- and intrastate blocking regimes and the FCC's authority to preempt to prevent frustration of the federal goal. Those petitions are pending.

If the expansive rationale sanctioned by the Ninth Circuit is closely followed, State per line blocking regimes are exposed to FCC preemption. Specifically, by using the Ninth Circuit's overbroad interpretation of § 152(b) and by alleging that the intrastate CID rules will impose added costs or "inefficiencies" on the carrier, the FCC could easily argue that preemption is appropriate.

Similarly, the Ninth Circuit's construct would sanction preemption of State telemarketing rules that differ from federal rules. Both the FCC and many States have adopted rules governing the terms for placing machine-dialed calls which deliver prerecorded, telemarketing messages to consumers. Approximately forty States regulate these calls, and most require a live operator introduce the call to obtain the informed consent of the called party to hear the recorded message. Like the State CID blocking rules, the purpose of the live operator requirement is to safeguard the privacy interests of consumers. Federal law, however, does not expressly require a live operator for similar interstate machine dialed calls. Accordingly, under the preemption standard articulated in *California II*, the FCC could contend that preemption of the live operator requirement is appropriate on the basis that it is inefficient or too costly for a telemarketer to comply with differing interstate and intrastate regimes.

Did Congress really mean to give the FCC such expansive authority when it sanctioned a dual inter- and intrastate regulatory regime?

The history of Section 152(b)[7], this Court's opinion in *Louisiana*, and common sense suggest that it did not. It is clear that Congress intended that telephone companies "which are engaged primarily in intrastate activities...should be subject to State and local regulation, rather than federal regulation."[8]

Again, CID service provides a useful example. Whenever interstate CID services ultimately are provided, 86% of the calls will still be intrastate.[9] In addition, consumers in over 43 jurisdictions will have been subject to their intrastate blocking regimes and other conditions of intrastate CID service for an average of 3.3 years by the FCC's April 1995 interstate CID implementation date.

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[7] Cf., NY PSC's discussion of Section 152(b)'s history in its petition at 8.

[8] S. Rep. No. 1090, 83rd Cong. 2d Sess., reprinted in 1954 Cong. Code and Admin. News 2133 (Emphasis added); Maryland v. FCC, 909 F.2d at 1515.

[9] Even with the increase in interstate call volume over the past 10 years, the overwhelming majority of calls, approximately 86%, continues to be intrastate. Cf. *Statistics of Communications Common Carriers*, 1992/1993 Edition, Federal Communications Commission at page 307, which shows that local and intrastate toll dial equipment minutes have remained above 84% for each of the 11 years referenced since 1980.

Moreover, allowing preemption under the *California II* rationale, under these circumstances would usurp the States' parens patriae role in protecting the privacy interests of its citizens and establishing emergency communications.[10]

Amici respectfully suggest that, under the dual regulatory scheme, Congress surely did not intend such carefully constructed State regulatory paradigms to be subject to the preemptive caprice of the FCC. Nor does it appear appropriate that a local ratepayer, local enhanced service competitor, or consumer harmed by a local exchange carrier's conduct involving a service like CID, which will be used - if historical trends continue - over 85% of the time for intrastate services, should be required to come all the way to the FCC's offices in Washington to seek relief.

---

[10] Prior to authorizing CID service, most states conducted extensive customer outreach and education programs to determine how best to balance the privacy interests of the calling and called parties. Decisions were often debated at some length in the local press and other forums. Many witnesses, including psychiatrists, social workers, police, other public safety officials, as well as family violence crisis centers, saw danger and/or nuisance, and a significant loss of privacy in allowing CID service to be offered without the option of per line blocking. In short, these CID proceedings were a microcosm of popular grass roots democracy in action.

Rather, it seems clear in such cases, Congress intended that such affected entities have the option of seeking relief from the more appropriately positioned State commission - the local agency steeped with in-depth knowledge of local market conditions and the local exchange carrier's other intrastate operations.

The important issue highlighted by the CID litigation is the rationale the FCC presented, and the Ninth Circuit sanctioned, to justify preemption.

If the *California II* rationale is followed in subsequent cases, any State regulation of intrastate portions of a service that does not exactly mirror the FCC's regulation of the complementary interstate service will be subject to (1) FCC charges of "economic inefficiency", and (2) FCC charges that the State regulation "thwarts" the FCC's general Section 151-derived policies. Thus, if other panels follow the Ninth Circuit's reasoning, it is difficult to imagine a circumstance where the FCC cannot, at will, contend that preemption of otherwise valid State regulation of the intrastate aspects of a "mixed jurisdictional service" is appropriate.

Moreover, as the FCC opinion approved in *California II* strongly suggests that there are no remaining services that can be construed as purely intrastate,[11] it is difficult to see how Section 152(b) imposes any "..jurisdictional limits on the power of [the FCC]..." at all. Cf. *Louisiana*, 476 U.S. 355, 373, 376 n. 5, 106 S.Ct. 1890, 90 L.Ed.2d 359, 384, 387 n. 5 (1986). Accordingly, *Amici* respectfully request that this Court grant certiorari and reverse the subject portions of opinion below.

---

[11] Essentially, the FCC has expanded the concept of "end-to-end" communication, a concept developed in a prior era when only toll-type services were at issue and mechanisms for identifying the jurisdictional nature of calls and services were not at issue. Basically, under the FCC construct, any service that can be accessed via a long distance call is "jurisdictionally mixed".

IX. CONCLUSION

For the foregoing reasons, the NY PSC and CPUC petitions for certiorari should be granted.

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APPENDIX A

Rule 33.2, U.S. Supr.Ct. Rule 33.2, 28 U.S.C.A. (1994), allows for additional counsel to be listed on the cover of a brief. As, with over forty parties, Counsel of Record was unable to fit them all on the inside covers of the brief, Counsel contacted Mr. Frank Lorson of the U.S. Supreme Court Clerk's office for advice. He suggested that we list as many as possible on the inside cover of the brief and then reference an appendix for the remainder.

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No. 94-1173

In the Supreme Court
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United States

OCTOBER TERM, 1994

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Petitioners,

VS.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,
Respondents.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

CALIFORNIA'S REPLY BRIEF

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CALIFORNIA'S REPLY BRIEF

PRELIMINARY STATEMENT

Contrary to respondents' argument, the issue in this case is whether the Federal Communications Commission ("FCC") may preempt state regulation applicable only to the intrastate portion of a telephone company's services whenever the FCC believes that such regulation is economically inefficient.

Respondents concede that it is technically feasible for a telephone company to comply with differing state and federal regulations when offering jurisdictionally-mixed en-

hanced services. Resp. Br. in Opp. at 9.[1] Moreover, respondents identify no federal regulation applicable to the interstate portion of enhanced services that is negated by a state structural safeguard applicable to the intrastate portion.

Instead, the sole basis of federal preemption here is the notion that state regulations will defeat the policy goal of efficiency stated in Section 151, 47 U.S.C. 151, when a state denies a telephone company the discretion to integrate its intrastate enhanced services with other services in order to avoid the costs of structurally separating its intrastate enhanced services. Resp. Br. in Opp. at 3, 6, 9. Respondents therefore acknowledge that Section 151 provides the only source of authority upon which the FCC has overridden the express bar of Section 152(b), 47 U.S.C. 152(b). Resp. Br. in Opp. at 10.

The Ninth Circuit's sanctioning of preemption on this basis directly conflicts with *Louisiana Pub. Serv. Comm'n v. FCC,* 476 U.S. 355 (1986), and decisions from the Fourth Circuit.

ARGUMENT

In *Louisiana,* this Court rejected "a broad reading of Section 151" which would permit the FCC to override Section 152(b) in order to preempt state regulation "which frustrates the ability of the FCC to perform its statutory function of ensuring efficient, nationwide phone service . . . " *Id.* at 370. This Court further refused to "accept an argument that the FCC may nevertheless take action which it thinks will best effectuate a federal policy," and thereby

---

[1] For example, neither the respondents nor respondents-intervenors dispute that it would be possible for a telephone company to assign separate personnel to market intrastate enhanced services on the one hand, and interstate enhanced and all basic telephone services (both interstate and intrastate) on the other.

"expand its power in the face of [the] congressional limitation [of Section 152(b)] on its jurisdiction . . . " *Id.* at 374. This Court said: "As we so often admonish, only Congress can rewrite this statute." *Id.* at 376.

Respondents nevertheless attempt to narrow *Louisiana* by inappropriately limiting Section 152(b)'s reach to ratemaking matters, an attempt that was flatly rejected in *Louisiana.* They state that, unlike in the case of ratemaking, the "interstate and intrastate aspects of telephone facilities or services cannot be separated so easily." Resp. Br. in Opp. at 8. In other words, there are costs involved in making such a separation. Respondents then claim that the FCC may override Section 152(b) whenever it believes that compliance with state requirements governing only the intrastate portion of jurisdictionally-mixed services and facilities would be uneconomic to the telephone company. However, if that claim were true, then "it would hardly have been necessary to deny the FCC the jurisdiction over 'charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service,' " since by definition a dual regulatory scheme imposes greater costs than a uniform scheme. *Louisiana,* 476 U.S. at 373. Congress expressly intended to limit the jurisdictional reach of the FCC with respect to each and every term set forth in Section 152(b) when state regulation over such terms is confined to the intrastate sphere.

Respondents and respondents-intervenors further attempt to limit Section 152(b)'s bar to "purely intrastate matters" — matters that have no interstate component — but that argument was also rejected by *Louisiana.* As respondents acknowledge, virtually all telephone facilities can be interchangeably used for interstate and intrastate services, and non-ratemaking regulation affects both interstate and intrastate communications. Resp. Br. in Opp. at 8. If the FCC may preempt state regulation applicable solely to the

intrastate portion of dual-use facilities and services which affects the economic efficiency of the telephone network, then nothing prevents the FCC from confining state regulation to "purely local" matters that do not affect interstate communication. *Louisiana*, 476 U.S. at 374.[2] As stated by this Court, that result "misrepresents the statutory scheme and the basis and test for pre-emption." *Ibid.*

Respondents next ignore language in *North Carolina Utils. Comm'n v. FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) ("*NCUC II*"), a case cited in *Louisiana* at 476 U.S. at 375 n.4 and fully consistent with *Louisiana*, that directly contradicts the Ninth Circuit's decision below. In *NCUC II*, the Fourth Circuit recognized that it was for the state commission to determine whether the economic and political costs of requiring facilities reserved exclusively for intrastate services were in the interest of intrastate consumers. *Id.* at 1049.[3] Here, the Ninth Circuit impermissibly permits the FCC to substitute its own judgment for the states', and thereby oust the states from weighing the costs and benefits of regulation confined to intrastate services and facilities, including the decision to recover such intrastate costs from intrastate consumers.

In sum, *Louisiana* makes clear that Congress intended Section 152(b) to fence off from FCC reach or regulation all matters — including practices, regulations, and facilities — confined to the intrastate portion of jurisdictionally-

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[2] In any event, the FCC's concession that states retain authority over "purely" intrastate services is illusory. Virtually all services interconnect with the national network, and hence virtually all services are partly interstate.

[3] Under *NCUC II*, it is only when the state chooses not to confine its requirements to intrastate facilities and services that a claim of preemption arises.

mixed services.[4] 476 U.S. at 370. The Ninth Circuit's decision impermissibly permits the FCC to scale this fence in order to effectuate the general efficiency goals of Section 151, and by doing so, effectively overrules *Louisiana*.[5]

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[4] *Louisiana* makes clear that where Sections 152(b) and 151 are in conflict, Section 152(b) prevails. 476 U.S. at 370 ("were we to find [Sections 151 and 152(b)] to be in conflict, we would be disinclined to favor the provision declaring a general statutory purpose, as opposed to the provision which defines the jurisdictional reach of the agency formed to implement that purpose.") Respondents concede that none of the Supreme Court cases other than *Louisiana* involved Section 152(b); hence, such cases are not relevant here.

[5] Respondents contend that review may not be warranted because the FCC is reconsidering its safeguards governing interstate enhanced services and may, however unlikely, change its regulation in a way which will obviate any conflict. However, in its Notice of Proposed Rulemaking, the FCC has indicated no intention to reverse its preemption decision. Moreover, Congress' reservation of authority to the states in Section 152(b) is at stake regardless of whether the FCC adopts new federal regulations for interstate services. Failure to review this case will leave the erroneous preemption standard in place and read the states out of the Communications Act. Accordingly, California, New York, the National Association of Regulatory Utility Commissioners, the National Association of State Utility Consumer Advocates, and forty-two state commissions, consumer advocates, and attorneys general respectfully urge this Court to review this case. *See* Joint Brief As Amici Curiae In Support of Petitioners.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

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March 16, 1995

[redacted]

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,

Respondents,

VOICE-TEL ENTERPRISES, INC., *et al.*,

Respondents-Intervenors.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

NEW YORK STATE REPLY TO BRIEFS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Nos. 94-1173, 94-1213

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1994

STATE OF NEW YORK, *et al.*,

Petitioners,

MARYLAND PEOPLE'S COUNSEL, *et al.*,

Petitioners-Intervenors,

-against-

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,

Respondents,

VOICE-TEL ENTERPRISES, INC., *et al.*,

Respondents-Intervenors.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

NEW YORK STATE REPLY TO BRIEFS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Preliminary Statement

The 1934 Communications Act safeguards the right of states to regulate intrastate telecommunications services. In fact, it expressly denies the Federal Communications Commission (FCC) jurisdiction over such matters. 47 U.S.C. § 152(b).[1]

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[1] *See* Hearings on S. 6 Before the Senate Interstate Commerce Committee, 73d Cong., 2d Sess. 2133, 2152 (1930) (statements of Sen. Dill); *id.* at 2179 (statement of Sen. Smith); *id.* at 2141 (statement of Sen. Brookhart).

Nonetheless, in 1982, the FCC preempted an aspect of intrastate telecommunications regulation on the theory that preemption was needed (and therefore justified) to effectuate a goal that FCC officials had developed pursuant to the FCC's general purpose of maintaining an efficient interstate network (47 U.S.C. § 151).[2] This Court annulled the FCC's action, noting that permitting the use of agency goals, developed pursuant to general purpose language (47 U.S.C. § 151), to preempt activities expressly reserved to the states by Congress (47 U.S.C. § 152(b)) "would be to grant to the agency power to override Congress." *Louisiana v. Federal Communications Comm'n.* 476 U.S. 355, 374-375 (1986).

The Ninth Circuit decision of which New York seeks review endorses FCC preemption of a section 152(b) activity to effectuate a goal developed by FCC officials pursuant to the agency's general purpose language (section 151). The decision directly conflicts with this Court's holding in *Louisiana.*

I.

The Respondents are simply incorrect in their claim that *Louisiana* endorses the use of goals developed by FCC officials under section 151's general purpose language to preempt areas of regulation expressly reserved to the states

New York's petition for certiorari showed that this Court's decision in *Louisiana* rejected unequivocally the FCC's argument that it could use goals culled from section 151's general purpose language to preempt the states' regulation of section 152(b)

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[2] *In the Matter of Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies,* Memorandum, Opinion and Order, 48 Fed. Reg. 2324 (January 18, 1983) (December Order).

activities (476 U.S. at 370-374).[3] The Court also rejected the FCC's Title II (section 220) preemption argument because, among other things, the separation of joint costs allowed the FCC to fulfill its section 220 duty to set depreciation charges without preempting (476 U.S. at 375-378). Finally, footnote 4 of *Louisiana* distinguished the Court's rejection of the FCC's section 220 claim that "the FCC cannot help but preempt state depreciation regulation of joint plant if it is to fulfill its *statutory obligation and determine depreciation* ..." (emphasis added; 476 U.S. at 375) from the Fourth Circuit's allowance of Title II [sections 201-205] interconnection preemption in *North Carolina Utilities Comm'n v. Federal Communications Comm'n,* 537 F.2d 787, 792-793 (4th Cir. 1976), *cert. denied,* 429 U.S. 1027 (1976) and *North Carolina Utilities Comm'n v. Federal Communications Comm'n,* 552 F.2d 1036 (4th Cir. 1977), *cert. denied,* 434 U.S. 874 (1977) (*NCUC* cases) on the ground that, unlike the case of depreciation, "it was not possible [in *NCUC*] to separate the interstate and intrastate components of the asserted FCC regulation" [interconnection]. 476 U.S. 375 at n.4. Each of these points was supported in New York's petition by references to the decision's text, footnote 4, and the Communications Act.

The Respondents' briefs do not address most of the reasons why one cannot logically read *Louisiana* as endorsing section 151 preemption. For example, neither the FCC nor its intervenors have taken issue with "the most fundamental problem" (NY Pet. 17) in the Ninth Circuit's reading of *Louisiana.* Specifically, one cannot logically interpret *Louisiana* as creating an "impossibility" exception that permits section 151 preemption because *Louisiana*

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[3]As the Court stated, "[we cannot accept] an argument that the FCC may ... take action which it thinks will best effectuate a federal *policy.* An agency may not confer power upon itself" (emphasis added). 476 U.S. at 374.

did not discuss (much less apply) such a test in rejecting the FCC's section 151 preemption argument. 476 U.S. at 370-374.

The FCC and its supporting intervenors' briefs do, however, offer several arguments why *Louisiana* should be read as endorsing section 151 preemption. Their contentions do not withstand scrutiny.

First, the Respondents claim that the *Louisiana* opinion did not address the FCC's section 220 [Title II] preemption position until the text following footnote 4 (Resp. 11; Resp. Int. 9 n.8).[4] The paragraph from which footnote 4 is derived rejected a claim of GTE and AT&T that, given that depreciation is intended to assure timely capital recovery, a failure by the FCC to preempt intrastate depreciation charges would violate the FCC's section 220 obligation to set depreciation charges (*see* NY Pet. 19). The text that immediately followed footnote 4 rejected a *different* section 220 theory; to wit, that section 220 as a whole mandated "automatic" preemption insofar as it required telephone companies to book only depreciation charges set by the FCC.

Second, in support of their contention that footnote 4 endorses section 151 policy preemption, the Respondents refer not to the footnote, or the text it accompanied, but a single sentence six pages before the footnote. The text referenced by the Respondents reads:

> In our view, the jurisdictional limitations placed on the FCC by section 152(b), coupled with the fact that the Act provides for a "separations" proceeding to determine the portions of a single asset that are used for interstate and

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[4]Their allegation is contradicted by the Ninth Circuit's decision, which acknowledged that the text explained by footnote 4 "discussed a Title II function" (NY App. A30).

> intrastate service, 47 U.S.C. § 410(c), answer both preemption [section 151/220] theories. *Louisiana*, 476 U.S. at 369 (Resp. 10-11).

The quoted language addresses the two principles that the Court developed at length in *Louisiana*. First, the jurisdictional limitations of section 152(b) defeated section 151 preemption (476 U.S. at 370-374). Second, the separations process, among other things, defeated the FCC's section 220 argument (476 U.S. at 375-378).

New York's petition pointed out that reading footnote 4 in context with the role of the separations process in *Louisiana* essentially proves that the footnote could not have been intended to create an impossibility exception allowing section 151 preemption (NY Pet. 23). In response, the Respondents offer the conclusory statement that "footnote 4 of the Court's opinion, which discussed the impossibility exception, is part of the Court's discussion of the significance of jurisdictional separations proceedings, which responded to the Commission's preemption theories under both Title I (section 151) and Title II (section 220) ..." (Resp. 10). The separability of costs was relevant to both of the FCC's preemption arguments, but it had opposite effects. That is, the separations process defeated the FCC's section 220 preemption argument, but it lent credence to the FCC's claim that the FCC had to preempt to avoid the frustration of its section 151 goal of modernizing the network.[5]

Footnote 4 could not have concerned section 151 preemption because it addressed an argument that had been rejected due to the

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[5]Again, the Court rejected the FCC's section 151 policy preemption argument because it conflicted with the plain language of section 152(b). 476 U.S. at 370, 374.

separability of costs.[6] Only the FCC's section 220 argument was rejected because of the separability of costs. Therefore, footnote 4 could only have referred to section 151 preemption if the Court had not understood the separations process. The text of *Louisiana* makes it very clear that the Court fully understood separations. 476 U.S. at 373, 375-376.

The Respondents also contend that footnote 4 must have endorsed section 151 preemption because it referred to the *NCUC* cases, which involved Title I preemption (Resp. 11). The *NCUC* cases involved section 151 *and* Title II preemption and, as discussed above, it was in the latter context that they were referenced in footnote 4. Prior text in *Louisiana* specifically rejected the FCC's reliance on *NCUC* for section 151 preemption (476 U.S. at 374).

Finally, the Respondents claim that *Louisiana* makes no distinction between section 151 and title II preemption (Resp. Int. 7). *Louisiana* not only rejects section 151 preemption (476 U.S. at 370-374), but it holds that although section 151 and 152(b) should normally be reconcilable, in cases of conflict "we would be disinclined to favor the provision declaring a general statutory purpose, as opposed to the provision which defined the jurisdictional reach of the agency formed to implement that purpose." 476 U.S. at 370. The Court's discussion of Title II preemption, which incidentally was *not* endorsed (476 U.S. at 376 N.5), focused on separations, the legislative history of section 220 and the FCC's ability to set depreciation charges without preempting. 476 U.S. 375-378. Thus, *Louisiana* certainly distinguishes between section

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[6]Specifically, footnote 4 distinguished the Court's *rejection* of an FCC preemption argument—because of the separability "of the asserted FCC regulation"—from two Fourth Circuit decisions where the asserted FCC regulation was *not* subject to separate interstate and intrastate components. 476 U.S. at 375 n.4.

151 preemption, which was rejected unequivocally, and Title II (section 220) preemption, which was rejected because of the separability of depreciation.

II.

Relevant Supreme Court precedent rejects the Respondents' contention that the FCC may use section 151's general purpose language to override section 152(b)'s specific denial of jurisdiction

In support of their claim that the FCC may use general policies to intrude on jurisdictional matters expressly reserved to the states by Congress, the Respondents cite *Capital Cities Cable, Inc. v. Crisp,* 467 U.S. 691; *United States v. Southwestern Cable Co.,* 392 U.S. 157 (1986); *Mississippi Power & Light Co. v. Mississippi ex rel. Moore,* 487 U.S. 354 (1988); and *City of New York v. Federal Communications Comm'n,* 486 U.S. 57, 66-70 (1988) (Resp. 10; Resp. Int. 7). None of these cases involved federal preemption of a section 152(b) activity.

To our knowledge, the only holding by this Court that addressed an FCC attempt to use a section 151 goal to preempt a section 152(b) activity is *Louisiana* and, in that case, the Court annulled the FCC's action. Further, as noted above, the Court concluded that "were we to find the sections to be in conflict, we would be disinclined to favor the provisions declaring a general statutory purpose, as opposed to the provision which defines the jurisdictional reach of the agency formed to implement that purpose." 476 U.S. at 370.[7]

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[7]The Respondents-Intervenors cite *Computer and Communications Indus. Ass's v. Federal Communications Comm'n (CCIA),* 693 F.2d 198 (D.C. Cir. 1982), *cert. denied,* 461 U.S. 938 (1983), which, unlike the *NCUC* cases, involved only section 151 preemption (Resp. Int. 11). The FCC and its supporting intervenors heavily relied on *CCIA* in *Louisiana* for the

(Continued on next page.)

The Intervenors claim that the FCC's *Computer III* Remand Order was issued pursuant "to both its Title I and Title II authority" (Resp. Int. n.6). The FCC has previously indicated that its *Computer III* order was not issued pursuant to Title II (*see People of the State of California v. Federal Communications Comm'n.* 905 F.2d 1217, 1240 n.35) and that it was not attempting to exercise title II jurisdiction over enhanced services.

The Respondents assert that state regulation of the areas which the FCC has attempted to preempt would "defeat the Commission's regulation of the same services" (Resp. (I) [Questions Presented]). The states are not attempting to regulate any interstate telecommunications service. However, in contending that section 151 goals form a basis for preempting areas expressly reserved to the states by section 152(b), the FCC is implicitly asserting that if a telecommunications service involves any percentage of interstate usage, FCC policies take precedence over state regulation.

While intrastate rates were required to give way to interstate regulation in the *Shreveport R.R. Rate Cases (Houston, East and West Texas Ry, Co. v. United States,* 234 U.S. 342 (1914)), section 152(b) was added to the 1934 Communications Act to prevent Shreveport's application to telecommunications. Hearings on S. 2910 Before the Senate Interstate Commerce Committee, 73d Cong., 2d Sess. 179 (1934). The Respondents essentially assert that section 152(b)'s safeguards apply only to rate regulation (Resp. 8-10; Resp. Int. 8), but this Court in *Louisiana* flatly rejected that position. In the Court's words: "we are not persuaded that it was anyone's understanding that this 'overruling' [of the *Shreveport* rate case] could or should be accomplished by merely

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(Continued from previous page.)
proposition that the FCC could use a section 151 goal to preempt section 152(b) activities, but, as discussed above, the Court rejected the FCC's position. 476 U.S. 370-374.

including in the Act one section which forbade the FCC to establish specific rates for certain intrastate services; had this been the intention, it would have hardly been necessary to deny the FCC the jurisdiction over 'charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service ...'" (476 U.S. at 373). In permitting the FCC to preempt state regulation of intrastate services in order to further a section 151 in-house policy, the Ninth Circuit has erroneously applied what can only be described as an aberration of the *Shreveport* doctrine to telecommunications.

Finally, the Respondents allege that attempts by the FCC to dictate the manner in which intrastate enhanced telecommunication services will be provided does not invite a "one fits all" agenda and that a failure to preempt would lead to "balkanization of the nation's telephone system and an emasculation of the FCC's plenary, regulatory authority over interstate communications" (Resp. Int. 12). In 1934, Congress recognized that telecommunications, like our nation, would be best served by a system that was unified, but not necessarily uniform. Instead of mandating centralized planning by the FCC, Congress left intrastate communications to on-the-scene state regulators who were best able to take measure of the needs and abilities of local customers.

With states serving as regulatory laboratories, a relatively primitive telephone system has blossomed into the most reliable, technologically advanced and affordable telecommunications network in the world. Permitting the FCC to preempt that states' regulation of intrastate communications simply to carry out policies of FCC officials would undercut the marriage of innovation and local responsibility that has served the country well for 50 years.

The advent of local telecommunications competition only accentuates the need for dual regulation. Programs for creating a fair playing field while protecting customers from potential rate shock differ significantly depending on customer needs, the local

telecommunications infrastructure and potential competitive interest. If state regulators are to implement these strategies in a meaningful, effective manner, they cannot be preempted by "one fits all" FCC policies developed pursuant to section 151's general purpose language.

In any event, as this Court has often noted, preemption analyses ultimately are reduced to the question, what did Congress intend. *E.g., Jones v. Rath Packing Co.*, 430 U.S. 519 (1977). The plain language of section 152(b), the legislative history of the Communications Act and this Court's decision in *Louisiana* leave no question that Congress intended to "safeguard the rights of the states ..." to regulate intrastate communication services. *See* Hearings on S. 6 Before the Senate Interstate Commerce Committee, 73d Cong., 2d Sess. 2141 (statement of Sen. Brookhart). In approving section 151 preemption of intrastate services, the Ninth Circuit's decision dramatically undermines those rights.

Conclusion

For the reasons discussed above, New York's Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit should be granted.

Dated: March 16, 1995

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